

Audit



Report

OFFICE OF THE INSPECTOR GENERAL

REIMBURSABLE ORDERS ISSUED TO THE
NAVAL UNDERSEA WARFARE CENTER,
KEYPORT, WASHINGTON

Report No. 97-084

January 29, 1997

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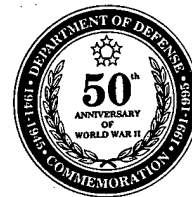
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Acronyms

APN	Aircraft Procurement Navy
DBOF	Defense Business Operations Fund
FAR	Federal Acquisition Regulation
MIPR	Military Interdepartmental Purchase Request
NAVAIR	Naval Air Systems Command
NAVCOMPT	Navy Comptroller
NAVSEA	Naval Sea Systems Command
OCI	OC, Incorporated
O&M,N	Operations and Maintenance, Navy



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884



January 29, 1997

**MEMORANDUM FOR ASSISTANT SECRETARY OF THE NAVY (FINANCIAL
MANAGEMENT AND COMPTROLLER)**

SUBJECT: Audit Report on Reimbursable Orders Issued to the Naval Undersea Warfare Center, Keyport, Washington (Report No. 97-084)

We are providing this report for review and comment. We conducted the audit in response to a complaint to the Defense Hotline. Management comments on a draft of this report were considered in preparing the final report.

DoD Directive 7650.3. requires that all recommendations be resolved promptly. We request that the Assistant Secretary of the Navy (Financial Management and Comptroller) provide additional comments on unresolved Recommendations A.1.a., A.2.a., A.2.b., A.3., B.1.a., B.1.b., B.1.c., and B.2., by March 28, 1997.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Terry L. McKinney, Audit Program Director, at (703) 604-9288 (DSN 664-9288) or Mr. Henry F. Kleinknecht, Audit Project Manager, at (703) 604-9324 (DSN 664-9324). See Appendix E for the report distribution. The audit team members are listed inside the back cover.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 97-084
(Project No. 6CF-8009.1)

January 29, 1997

Reimbursable Orders Issued to the Naval Undersea Warfare Center, Keyport, Washington

Executive Summary

Introduction. This is the second of two reports addressing a complaint to the Defense Hotline about reimbursable orders issued to the Naval Undersea Warfare Center, Keyport, Washington (Keyport). This report discusses the complaint that Keyport was improperly accepting reimbursable orders for intra-agency contracting and charged various improper taxes to reimbursable customers, in addition to the approved Keyport stabilized rate. The report also discusses Government property supplied to a support services contractor. The first report discusses a \$30 million sole-source Section 8(a) contract for Federal Information Processing Resources.

Keyport operates as a Defense Business Operations Fund activity that provides goods and services, on a reimbursable basis, to the Navy and other DoD organizations. In FY 1995, Keyport received reimbursable orders, totaling \$258 million, from 17 major customers. Keyport charges its customers a predetermined stabilized hourly rate and other taxes to recover its operating costs.

Audit Objectives. The primary audit objective was to determine whether the Hotline complaint had merit. Specifically, the complainant alleged that the Naval Air Systems Command, Aviation Training Systems program office (the program office), was improperly using reimbursable orders issued to Keyport for intra-agency contracting and that Keyport was not performing 51 percent of the work or services with in-house resources. The complaint also alleged that Keyport was improperly charging reimbursable customers taxes in addition to the approved stabilized rate. The audit also reviewed Government property supplied by Keyport to a support services contractor and evaluated the Keyport management controls related to reimbursable orders and Government property.

Audit Results. The Hotline complaint was substantiated.

- o The program office issued reimbursable orders to Keyport without an adequate description of the work or services required. Keyport accepted orders for intra-agency contracting from the program office on a reimbursable basis, but was not performing 51 percent of the work or services in-house. As a result, competition may have been restricted and normal procurement support channels were bypassed (Finding A).

- o Keyport charged taxes in addition to the Keyport stabilized rate to its Defense Business Operations Fund (DBOF) customers. The Keyport stabilized rate charged DBOF customers was understated, and DBOF customers were charged taxes by Keyport to recover its actual costs. Thus, customers were not protected from unforeseen cost increases and were charged higher than anticipated costs of about \$26 million in FYs 1995 and 1996. The additional costs should have been included in the stabilized rate (Finding B).

- o Keyport provided office furnishings and data processing equipment (as Government property) to the Keyport support services contractor supporting the program office. Keyport also improperly purchased data processing equipment for Government use with investment

versus expense funds. As a result, the DoD unnecessarily financed contractor office furnishings and data processing equipment totaling \$195,913, and investment funds were used to purchase data processing equipment (Finding C).

The management control programs could be improved. We identified material weaknesses related to issuing and accepting reimbursable orders, the Keyport stabilized rate and other taxes, and Government property (Appendix A). Implementing the recommendations will strengthen management controls. See Part I and Appendix A for the details of our review. See Appendix D for a summary of potential benefits resulting from the audit.

Summary of Recommendations. We recommend that the program office direct cite funds for intra-agency contracting, discontinue issuing reimbursable orders without adequate descriptions of work or services, and determine whether a valid requirement exists for uncommitted funds. We recommend that Keyport not accept reimbursable orders for intra-agency contracting and return uncommitted funds on reimbursable orders to the program office. We recommend that the Comptroller, Naval Air Systems Command, deobligate program office funds that are not committed at Keyport and use expense versus investment funds for contract execution and management services. We recommend that Keyport discontinue taxing reimbursable customers for support costs, include these taxed costs in the Keyport stabilized rate, and increase controls over Government property, to include not providing general-purpose equipment to contractors. We recommend that the Commander, Naval Undersea Warfare Center, review the performance of Keyport officials who disregarded guidance and take appropriate action. We recommend that the Commander, Naval Sea Systems Command, review the formulation of stabilized rates at other DBOF activities and reemphasize DoD policy on improper taxes. We recommend that the Commander, Naval Air Systems Command, ensure compliance with existing procurement procedures.

Management Comments. The Navy fundamentally disagreed with what constitutes in-house costs versus contractor services and what costs should be included in the stabilized rate for DBOF activities. The Navy nonconcurred with recommendations relating to the 51-percent in-house rule and billing practices at other DBOF activities. The Navy concurred with the recommendation to direct cite funds, commenting that uncommitted funds had been reduced from \$7.9 million to \$153,400. The Navy also concurred with the recommendation to discontinue issuing reimbursable orders without adequate descriptions of work or services. The Navy agreed with the intent of the recommendation to discontinue taxing reimbursable customers for support costs and agreed to change its method of charging reimbursable customers. The Navy also concurred with the recommendations concerning Government property, including the recommendation not to provide Government property to contractors. See Part I for a summary of Navy comments on the findings, recommendations, and monetary benefits and Part III for the full text of Navy comments.

Audit Response. We disagree with the Navy about compliance with the 51-percent in-house rule. Table 4 in the report shows that 92 percent of the funds spent on reimbursable orders were for contractor services and materials. Of the remaining 8 percent of the funds, only 5 percent represented actual labor and travel costs associated with Keyport employees. Also, each task order relating to the contractor services clearly identified a specific deliverable for the program office. Although Keyport may have provided some technical support, the actual contract deliverables were prepared by the contractor. Under the Navy's concept of the 51-percent rule, the Navy would always be in compliance as long as contractor oversight was provided. We also believe the Navy's use of service cost centers is contrary to the DBOF stabilized rate concept. We request that the Navy provide comments on this final report by March 28, 1997.

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Part I - Audit Results

Introduction

This report resulted from a complaint to the Defense Hotline and is the second of two reports about reimbursable orders accepted by the Naval Undersea Warfare Center, Keyport, Washington (Keyport), to provide intra-agency contracting for the Naval Air Systems Command (NAVAIR), Aviation Training Systems Program Office (the program office). The report also discusses the Keyport stabilized rate, various surcharges, and Government property supplied to a contractor.

Audit Background

Aviation Training Systems Program Office Mission. The program office provides total life-cycle management for naval aviation training systems. Total life-cycle management includes providing general training equipment and support to meet fleet and shore establishment needs. The goals of the program office are to develop training systems concurrent with the acquisition of the parent weapon systems, maintain weapon system training configurations, and manage emerging training system technologies. Program office responsibilities include supporting specific training for weapons systems, general training, and various areas of research and development. The program office must also remain abreast of latest technologies, such as computer-based training, interactive simulation, and virtual reality.

NAVAIR Contracting Office Mission. NAVAIR has dedicated contracting officers that support NAVAIR programs and programs managed by other program executive officers. The NAVAIR contracting office has a staff of about 985 and awards contracts totaling about \$9 billion annually. Although the program office could rely on extensive contracting support and experience within NAVAIR, the program office chose Keyport for contract execution and management services.

Keyport Mission. Keyport supports the mission of the Naval Undersea Warfare Center by providing test and evaluation, in-service engineering, maintenance and repair, fleet support, and industrial base support for undersea warfare systems, undersea weapons systems, countermeasures, and sonar systems. Keyport operates as a Defense Business Operations Fund (DBOF) activity for the Naval Sea Systems Command (NAVSEA) and provides goods and services, on a reimbursable basis, to the Navy and other DoD activities.

In FY 1995, Keyport received reimbursable orders totaling \$258 million from 17 major customers. About \$28 million of the reimbursable work supported NAVAIR. Keyport charges its customers about 10 percent of the total value of reimbursable orders for operating costs at Keyport. The Keyport contracting office has five staff members and the authority to award contracts up to and including \$100,000. For contract awards greater than \$100,000, Keyport uses contracting personnel at Fleet Industrial Supply Centers.

Table 1 shows the amount of FY 1995 reimbursable funds that Keyport received by sponsor and appropriation.

Sponsor	O&MN	APN	WPN	OPN	RDT&E,N	SCN	DBOF	FMS	Total
NAVSEA	\$65.4	\$0.0	\$56.2	\$17.7	\$5.0	\$10.6	\$0	\$21.6	\$176.5
NAVAIR	2.9	24.5	0	0.2	0.1	0	0.3	0	28.0
SPCC	0.1	0	0	0	0	0	10.1	0.7	10.9
Other Navy	4.8	0.3	0	0	2.1	0	1.4	1.0	9.6*
Pacific Fleet	7.0	0	0	0	0	0	0	0	7.0
NUWC	0	0	0	0	0	0	6.5	0	6.5
Other (MIPR)	4.4	0	0	-1.2	0.2	1.0	1.0	0	5.4
NSWC	0	0	0	0.3	0	0	3.3	0	3.6
Non DoD	0	0	0	0	0	0	0	0	3.6
Atlantic Fleet	3.0	0	0	0	0	0	0	0	3.0
OPTEVFOR	0	0	0	0.1	2.6	0	0	0	2.7
SPAWAR	1.2	0	0	0	0.1	0	0	0	1.3
Total	\$88.8	\$24.8	\$56.2	\$17.1	\$10.1	\$11.6	\$22.6	\$23.3	\$258.1
APN	Aircraft Procurement, Navy								
FMS	Foreign Military Sales								
MIPR	Military Interdepartmental Purchase Request								
NSWC	Naval Surface Warfare Center								
NUWC	Naval Undersea Warfare Center								
O&MN	Operation and Maintenance, Navy								
OPN	Other Procurement, Navy								
OPTEVFOR	Navy Operational Test and Evaluation Force								
RDT&E,N	Research, Development, Test and Evaluation, Navy								
SCN	Shipbuilding and Conversion, Navy								
SPAWAR	Space & Naval Warfare Systems Command								
SPCC	Navy Ship Parts Control Center								
WPN	Weapons Procurement, Navy								

*Includes \$7.4 million Other Navy and \$2.2 million from five other sponsors each less than \$1 million.

Memorandum of Agreement Between the Program Office and Keyport.
The program office and Keyport have a memorandum of agreement governing all projects assigned to Keyport by the program office. Section 5 of the memorandum or agreement describes program office and Keyport responsibilities.

5. Responsibilities.

PMA205 [program office] shall provide:

- o identification of scientific, technological, and program-support needs to NUWC [Naval Undersea Warfare Center] Keyport in mission-related areas;
- o descriptions of assigned task requirements and points of contact for each project; and
- o funding necessary to support execution of task assignments.

Audit Results

NUWC Keyport shall provide:

- o proposal, negotiation, execution and oversight of all PMA205 requirements assigned to NUWC Keyport for action;
- o points-of-contact for each task assignment;
- o representation at program reviews and other meetings as required;
- o status reports and other documentation on assigned projects for execution, as specified in task assignment(s);
- o proposals for existing and emerging technologies for application to PMA205 requirements; and
- o execution and management of required contracts and requisitions.

Since FY 1992, Keyport has supported the program office by using three support services contracts with the same contractor, OC, Incorporated (OCI). The contractor has provided engineering, technical support, logistics, maintenance, and training support for aircraft and associated systems.

Audit Objectives

The primary audit objective was to determine whether complaints made to the Defense Hotline had merit. Specifically, the complaint alleged that the Naval Air Systems Command, Aviation Training Systems program office (the program office), was improperly using reimbursable orders issued to Keyport for intra-agency contracting and that Keyport was not performing 51 percent of the work or services with in-house resources. The complaint also alleged Keyport was improperly charging reimbursable customers taxes in addition to the stabilized rate approved in the budget. The audit reviewed Government property supplied by Keyport to a support services contractor and evaluated the Keyport management controls related to reimbursable orders and Government property. See Appendix A for a discussion of the audit scope and methodology and Appendix B for a summary of prior coverage related to the audit objectives. See the findings for a discussion the material weakness identified and Appendix A for details of our review of the management control program.

Finding A. Reimbursable Orders for Intra-Agency Contracting

The Naval Aviation Training Systems program office (the program office) issued reimbursable orders to the Naval Undersea Warfare Center, Keyport (Keyport), without an adequate description of the work or services required. Keyport accepted, on a reimbursable basis, orders from the program office for intra-agency contracting and disregarded Navy Comptroller guidance that requires at least 51 percent of the work or services be performed with in-house resources¹ before a reimbursable order can be accepted. Issuing reimbursable orders without adequate descriptions of the work or services required allowed the program office to get funds obligated, while retaining flexibility in their use. As a result, the program office was able to obtain services from a desired contractor without NAVAIR contracting oversight and may have restricted competition. The program office also reduced oversight of uncommitted funds and used procurement funds to obtain contract execution and management services from Keyport. Keyport obtained additional reimbursable business and was able to charge the program office improper taxes to recover Keyport expenses. As of April 1, 1996, Keyport accounting records showed 9 reimbursable orders from the program office with about \$7.9 million of uncommitted FYs 1994 and 1995 APN funds that have been uncommitted for an extended period. The funds are shown as obligated on the official Navy accounting records.

Guidance on Intra-Agency Contracting, Reimbursable Orders, Bona Fide Need, and Comptroller Responsibilities

Congressional Guidance on Ordering Within the Same Agency or Another Agency. United States Code, title 31, section 1535 (31 U.S.C. 1535), "Agency Agreements," generally permits orders for goods and services to be placed with a major organizational unit either within the same agency or at another agency, so long as the orders are in the best interest of the Government. Congress directed that the Secretary of Defense prescribe regulations for purchases made through other agencies (also known as Economy Act orders). The inter-agency regulations require such purchases to be approved in advance by a designated approving official. In addition, purchases must be made under a preexisting contract of the servicing agency being used to purchase the same or similar goods or services.

¹NAVAIR guidance requires at least 80 percent.

Finding A. Reimbursable Orders for Intra-Agency Contracting

Navy Guidance on Reimbursable Orders (51-Percent In-house Rule). Volume 3, "Appropriation, Cost, and Property Accounting (Field)," March 23, 1995, of the Navy Comptroller (NAVCOMPT) Manual series provides guidance on when Navy activities can accept reimbursable orders. Section 035411, "Acceptance of Reimbursable Orders," states

1. GENERAL. Reimbursable orders may be accepted by any DoN [Department of Navy] activity that has been granted an allocation of funds and intends to *perform at least 51 percent of the work or services with in-house resources*. "In-house" shall include costs of all direct labor, material and supplies, travel and minor equipment. For industrial fund and non industrial fund activities authorized to distribute overhead, it shall include all authorized overhead costs. "In-house" shall include contracts for technical support which is usable only to the performing activity in its accomplishment of the overall work required by the issuer. . . . *Excluded from the definition of In-house efforts are those contractual efforts which produce the product or service required by the customer, with only contract management provided by the performing naval activity.* [emphasis added]

NAVAIR Guidance on In-house Resources. On February 20, 1996, the Commander, NAVAIR, issued detailed guidance "Review of Program Levels of Carryover at Naval Air Systems Command Defense Business Operations Fund Activities," that stated NAVAIR DBOF activities are required to perform at least 80 percent of the work and services with in-house resources for funds accepted as reimbursable.

Navy Guidance on Acceptance of Reimbursable Orders. Volume 5, "Navy and Marine Corps Industrial Funds," July 29, 1981, of the NAVCOMPT Manual series provides general guidance on the acceptance of reimbursable orders. Section 054010, "Receipt of Orders," states

2. SPECIFICATIONS. In order to accept the order for work or services the following criteria must be met:

1. work will commence within a reasonable period of time, as a general rule within 90 days of acceptance of the order. . . .

2. it is intended that a substantial portion of the effort will be accomplished through the use of in-house personnel and facilities. . . . When a substantial portion of the work will not be performed in-house, a reimbursable order for only the in-house portion of the work, including the in-house effort related to the performance of procurement will be accepted. A Request for Contractual Procurement will be accepted to fund the cost of the contracts;

3. the order must include an adequate description of the work or services required, the specific physical completion date, identification of any applicable sponsor/government-furnished material to be used, sufficient funding to cover the total anticipated cost of the requested work and the complete accounting data required for billing purposes. . . .

Finding A. Reimbursable Orders for Intra-Agency Contracting

DoD Guidance on Obligations. DoD 7220.9-M, "Department of Defense Accounting Manual," October 1983, Chapter 25, "Standards for Recording Commitments and Obligations," provides standards for recording commitments and obligations. Section C., "Obligations," states that the following principles shall be applied.

b. Performance Under Contracts or Orders. Contracts entered into or orders placed for goods, supplies, or services shall be executed only with bona fide intent that the contractor (or other performing activity) shall commence work and perform the contract without unnecessary delay.

Comptroller Responsibilities. Volume 5 of the NAVCOMPT Manual series, Section 051101, "Responsibilities/Functions," describes the responsibilities and functions of the comptroller and deputy comptroller for DBOF activities.

1. **RESPONSIBILITIES.** The Comptroller, as the individual responsible for the organization and administration of matters pertaining to budgets, accounting, reports, and statistics has the responsibility for the following functions that are promulgated and/or performed within the Comptroller Organization:

1. implement and administer the laws, policies, regulations, directives, and instructions pertaining to the financial operations of the activity. . . .

Reimbursable Orders for Work of Services

Adequate Description of Work or Services Required. The program office improperly issued Keyport reimbursable orders without an adequate description of the work or services required. The program office then provided guidance to Keyport on the requirements for the funds. As shown in the following example, the Keyport support services contractor was also tasked to define work or services required.

For example, on May 18, 1995, Keyport accepted a reimbursable order from the program office for \$10 million. The reimbursable order referenced a NAVAIR air task that contained only general information on engineering and technical support required to upgrade the F/A-18 training system. Air tasks are documents that provide supplemental guidance to the description of work or services required on reimbursable orders. When the reimbursable order was issued to Keyport, the program office only knew that it wanted to upgrade the F/A-18 maintenance training system.

Consequently, on August 28, 1995, Keyport issued its services contractor, OCI, a delivery order for \$324,140 to deliver an F/A-18 Navy Training Plan. Then on January 4, 1996, Keyport issued OCI a delivery order for \$350,033 to prepare an F/A-18 maintenance training system upgrade study and provide upgrade recommendations. The study required examination of existing curriculum and instructional processes detailed in the Navy Training Plan.

Finding A. Reimbursable Orders for Intra-Agency Contracting

Finally, on April 10, 1996, Keyport issued OCI a delivery order for \$6,111,813, to design, produce, and integrate an upgrade to the Naval Air Maintenance Training Group F/A-18 maintenance training system. The design, production, and integration of the upgrade were based on recommendations from the previous delivery order. In summary, the program office did not have an adequate description of the work or services required until 11 months after Keyport received the reimbursable order. Without knowing the specific work requirements, the program office was able to "bank" the funds at Keyport for about 330 days. Appendix C provides a list of the reimbursable orders reviewed from the program office and a summary of the description of work or services.

Reimbursable Orders for Intra-Agency Contracting. Keyport improperly accepted, on a reimbursable basis, orders for intra-agency contracting from the program office. Keyport used the reimbursable orders to obtain contractual engineering and technical services and did not perform 51 percent of the work or services with in-house resources on 20 of the 24 reimbursable orders reviewed. In addition, the contractual services obtained by Keyport were used to produce the products and services required by the program office with Keyport primarily providing contract execution and management services and minimal technical support. These contracting services could have easily been provided by the NAVAIR contracting organization. Keyport personnel stated that they were not qualified to perform the engineering and technical services required by the program office. Keyport acted as a contract execution and administration office for the program office and did not significantly alter or modify contract deliverables or provide significant added value to the product; therefore, the contract deliverable was the final end product.

Obligation of Reimbursable Funds

Reimbursable Funds Obligated on NAVAIR Accounting Records. The program office issued reimbursable orders to Keyport without an adequate description of the work or services required obligating the funds on NAVAIR accounting records. When the program office issues orders to Keyport on a reimbursable basis and the order is accepted by Keyport, the funds are shown as obligated on NAVAIR accounting records. Had the program office followed NAVCOMPT guidance and issued orders with a direct citation of funds, the funds would not have been shown as obligated on NAVAIR accounting records until Keyport had actually executed the contract or delivery orders. Further, since Keyport was not performing 51 percent of the work or services with in-house resources, the funds for contractor services are required to be direct cited. The program office needs to direct cite funds for intra-agency contracting.

Reimbursable Funds Uncommitted at Keyport. In the reimbursable funding documents that we reviewed, the program office did not provide sufficient, detailed information for Keyport to execute the orders for work or services. The reimbursable orders often cited NAVAIR air tasks, which provided only minimal supplemental guidance. Because Keyport did not receive an adequate

Finding A. Reimbursable Orders for Intra-Agency Contracting

description of the work or services required, Keyport was unable to actually get the reimbursable funds committed or obligated on contract delivery orders, MIPRS, or work requests to other Navy activities within a reasonable time. In order to establish a valid obligation, orders for work and services must be specific and definite before transferring funds. In addition, reimbursable orders are not to be issued as reimbursable work estimates. Program office acquisition managers should not issue orders for work and services to other Navy activities without an adequate description of the work or services required.

Reasonable Period of Time for Keyport to Obligate Funds. Keyport was unable to get contract delivery orders, Military Interdepartmental Purchase Requests (MIPRs), and work requests issued within a reasonable period of time.

Table 2 shows that 19 of the 33 contract delivery orders, MIPRS, and work requests issued by Keyport against the reviewed NAVAIR reimbursable orders took longer than 90 days to award. Over 50 percent of the reimbursable funds took longer than 181 days to actually obligate on Keyport accounting records.

Table 2. Days for Keyport to Obligate Reimbursable Funds on Contract Delivery Orders, MIPRS, and Work Requests to Other Navy Activities

<u>Day From Receipt of Funds Until Keyport Obligation</u>	<u>Number of Delivery Orders, MIPRs, and Work Requests</u>	<u>Value</u>
0 through 90	14	\$ 4,064,201
91 through 180	11	3,267,141
181 and over	8	<u>7,547,247</u>
Total	33	\$14,878,589

Uncommitted NAVAIR APN Funds From FYs 1994 and 1995. Table 3 shows 9 reimbursable orders from the program office, totaling close to \$7.9 million in FY 1994 and 1995 APN funds, that had been uncommitted on Keyport accounting records for periods ranging from 188 to 451 days. Although these funds are shown as "obligated" on the official NAVAIR accounting records, the program office did not provide Keyport an adequate description of the work or services required, preventing Keyport from placing these funds on contract within a reasonable time. Consequently, the Keyport accounting records do not match the official Navy accounting records. When questioned about the intended use of these funds, Keyport fund managers were unable to provide an adequate description of the required work or services associated with the funds.

Finding A. Reimbursable Orders for Intra-Agency Contracting

Table 3. NAVAIR APN Funds From FYs 1994 and 1995 Issued to Keyport on Reimbursable Orders That Are Uncommitted on Keyport Accounting Records (As of April 1, 1996)

Item Number	Reimbursable Order Amount	Date Reimbursable Accepted	Amount Charged	Contingent Liability	Uncommitted Funds	Total Days Funds Uncommitted From Date Order Accepted
4	\$ 527,000	04-Apr-95	\$ 166,497	\$ 294,771	\$ 65,732	363
8	250,000	14-Jul-95	67,363	113,400	69,237	262
12	7,580,000	21-Jun-95	1,213,849	2,198,214	4,167,937	285
17	10,000,000 ¹	18-May-95	471,696	6,699,539 ²	2,828,765	319
18	423,356	26-Sep-95	19	0	423,337	188
19	789,995	06-Jan-95	678,342	0	111,653	451
20	340,586	09-Aug-95	80,836	159,459	100,291	236
23	300,000	08-Feb-95	162,185	86,929	50,886	418
24	900,000	15-Sep-95	53,195	810,611	36,194	199
Total	\$21,110,937		\$2,893,982	\$10,362,923	\$7,854,032	

¹FY 1994 funds.

²Includes \$6,111,813 delivery order issued on April 10, 1996.

Because Keyport improperly accepted these reimbursable orders from the program office, the Commander, Keyport, needs to direct the Keyport comptroller to return the uncommitted funds to the program office. Because the funds have been uncommitted at Keyport for such a long time and because the Keyport fund managers have not received an adequate description of the required work or services associated with the funds, the program office and NAVAIR comptroller should determine whether a valid requirement still exists for the funds or whether the funds could be put to better use. See Appendix D for a summary of the potential benefits (including monetary) resulting from the audit.

Keyport Acceptance of Reimbursable Orders

Navy Comptroller 51-Percent Rule. Keyport disregarded the Navy Comptroller requirement that at least 51 percent of the work or services be performed with in-house resources² and improperly accepted, on a reimbursable basis, orders from the program office for intra-agency contracting. These practices helped Keyport obtain additional business and increased Keyport's control over the funds.

²NAVAIR guidance requires at least 80 percent.

Finding A. Reimbursable Orders for Intra-Agency Contracting

Table 4³ shows that on 20 of the 24 reimbursable orders Keyport accepted from NAVAIR, the majority of the work or services was not performed with in-house Keyport resources. In fact, about 92 percent of the funds on the reimbursable orders were spent for contractor services and materials.

Table 4. Reimbursable Work Performed With Contractor Services (51-Percent Rule)

Item Number	Reimbursable Amount	Uncommitted Amount	Amount Committed, Obligated, or Expended	Total Contractor Services*	Total Material	Contractor Services and Materials	
						Total	Percent
1	\$ 185,000	\$ 5,193	\$ 179,807	\$ 135,787	\$ 740	\$ 136,527	76
2	458,000	0	458,000	428,249	336	428,585	94
3	441,000	0	441,000	181,049	177,340	358,389	81
4	527,000	65,732	461,268	388,809	821	389,630	84
5	362,000	0	362,000	326,266	0	326,266	90
6	210,000	1,484	208,516	140,000	44,312	184,312	88
7	200,000	0	200,000	179,921	0	179,921	90
8	250,000	69,237	180,763	178,400	0	178,400	99
9	150,000	3,295	146,705	129,232	0	129,232	88
11	450,000	2,128	447,872	405,000	13,530	418,530	93
12	7,580,000	4,167,937	3,412,063	3,087,870	25,184	3,113,054	91
13	950,000	25,974	924,026	749,795	10,200	759,995	82
15	586,993	444	586,549	453,944	85,031	538,975	92
16	900,000	12,798	887,202	825,504	9,117	834,621	92
17	10,000,000	2,826,437	7,173,563	6,834,958	28,676	6,863,634	96
19	789,995	111,653	678,342	583,766	146	583,912	86
20	340,586	100,291	240,295	0	182,234	182,234	76
22	230,000	15,373	214,627	207,000	0	207,000	96
23	300,000	50,886	249,114	221,903	1,066	222,969	90
24	900,000	36,194	863,806	756,612	14,497	771,109	89
Total							
	\$25,810,574	\$7,495,056	\$18,315,518	\$16,214,065	\$593,230	\$16,807,295	92

* Contractor services includes work requests sent to other Navy organizations and Military Interdepartmental Purchase Requests.

A significant amount of the materials was improperly acquired as Government property for contractor use (see Finding C). Keyport did perform the majority of the work with in-house resources on the reimbursable orders corresponding to our item numbers 10, 14, 18, and 21. Also, we reviewed 17 other reimbursable orders relating to Naval Sea Systems Command sponsors. We found that Keyport did perform the majority of the work or services with in-house resources on these reimbursable orders.

Keyport Responsibility for Accepting Reimbursable Orders. The Keyport comptroller, deputy comptroller, and other Keyport fund managers all knew about the Navy Comptroller's 51-percent rule. However, the Navy Comptroller guidance was disregarded and the reimbursable orders from the program office

³Appendix C shows the document number, appropriation, reimbursable amount and description of work or services for the 24 NAVAIR reimbursable orders reviewed. The item number in the table corresponds with a document number in the appendix.

Finding A. Reimbursable Orders for Intra-Agency Contracting

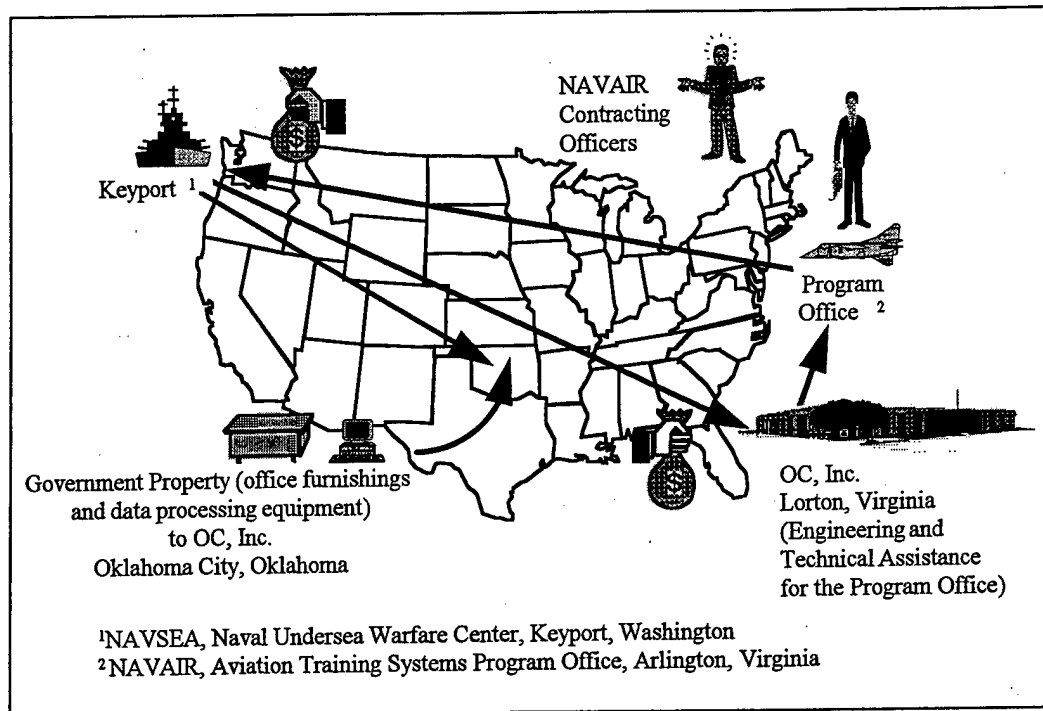
for intra-agency contracting were accepted, resulting in Keyport obtaining additional business and control of funds. The Commander, Keyport, needs to require that the Keyport comptroller, deputy comptroller, and other fund managers follow Navy Comptroller guidance. The Commander, Naval Undersea Warfare Center, needs to independently review the performance of the Keyport comptroller, Deputy comptroller, and other fund managers who disregarded Navy Comptroller guidance and take appropriate action to prevent future problems.

Intra-Agency Contracting for the Program Office

Obtaining Contractor Services. The program office was able to "offload" contracts to Keyport and thus obtain services from a desired contractor and avoid contracting oversight by NAVAIR. Since 1992, three contracts have been awarded to the same contractor (OCI) to provide engineering and technical services for the program office at a total maximum value of \$68 million. All three contracts were cost-plus-fixed-fee contracts. The major subcontractor on the OCI contracts is a contractor named Information Spectrum, Inc. The NAVAIR contracts division also awarded an engineering and technical services contract for the program office to Information Spectrum, Inc. The NAVAIR contract is a time-and-materials contract and has a maximum contract value of about \$58 million. The NAVAIR contracting office was unaware of the program office's other contracts with OCI for engineering and technical services.

Finding A. Reimbursable Orders for Intra-Agency Contracting

The figure shows that the program office sent funds across the country to Keyport and then Keyport obtained contractor services for the program office from a contractor located near the program office.



Program Office Used Keyport to Obtain Contractor Services

Banking Appropriated Funds. The program office was banking (obligating funds before delivery orders were awarded) appropriated funds to get the funds obligated as soon as possible. As previously discussed, once the program office was notified by Keyport that the reimbursable orders were accepted, the funds were obligated on NAVAIR accounting records, even though the funds remained uncommitted at Keyport for extended periods. Tables 3 and 4 show the extent of appropriated funds banking by the program office.

Procurement Funds for Contract Execution and Management Services. Keyport provided basic contract execution and management services to the program office for a fee. For example, Keyport personnel negotiated task orders with the contractor and reviewed contract cost performance reports. Keyport charged these labor and overhead costs directly to the APN-funded reimbursable orders. In addition, Keyport directly charged the APN-funded reimbursable orders for costs associated with training, travel, and long-term temporary duty for Keyport personnel; technical and purchasing office taxes; futures taxes (see Finding B for details on Keyport taxes); and for a support services contractor to support the Keyport contract execution and management function. From March 1993 through July 1996, Keyport had an individual on long-term temporary duty to the NAVAIR program office at a total cost of \$103,680 for travel and per diem.

Finding A. Reimbursable Orders for Intra-Agency Contracting

Table 5 shows that on 13 of the APN-funded reimbursable orders, the program office spent about \$1.1 million of procurement funds for various contract execution and management services from Keyport.

Table 5. Summary of Keyport Reimbursable Order Support Costs for APN-Funded Reimbursable Orders

Item Number	Reimbursable Amount	Labor and Travel Costs	Technical and Purchasing Office Taxes	Futures Taxes	Total	Percentage of Reimbursable Amount
2	\$ 458,000	\$ 22,774	\$ 0	\$ 17,882	\$ 40,656	9
4	527,000	39,043	2,867	0	41,910	8
5	362,000	38,501	0	0	38,501	11
8	250,000	0	95	0	95	0
11	450,000	10,040	18,624	0	28,664	6
12	7,580,000	85,469	140,838 ¹	68,572	294,879	4
13	950,000	140,554 ²	11,121	0	151,675	16
16	900,000	3,362	484	43,892	47,738	5
17	10,000,000	190,585	21,629	124,842	337,056	3
19	789,995	7,880	70,950 ³	0	78,830	10
20	340,586	52,352	5,705	0	58,057	17
23	300,000	18,287	5,040	0	23,327	8
24	900,000	2,764	35,935	0	38,699	4
Total	\$23,807,581	\$ 611,611	\$313,288	\$255,188	\$1,180,087	5

¹Includes \$95,325 of Vitro NAVAIR Program Management Support.

²Includes \$16,492 of travel costs for a Keyport employee to act as a liaison with NAVAIR program office.

³Includes \$41,168 of Vitro NAVAIR Program Management Support.

The NAVAIR comptroller should make accounting adjustments to fund Keyport labor and travel costs for contract execution and management services and Keyport taxes with expense versus investment funds.

Keyport Reimbursable Business

Additional Keyport Business. Keyport has marketed itself to the program office as a means of obtaining additional business in the form of intra-agency contracting support. Table 1 shows that NAVAIR sent Keyport about \$28 million in FY 1995 reimbursable funds. This represents a little over 10 percent of the total Keyport reimbursable business for FY 1995. The services provided by Keyport for a fee consist of contract execution and management services for the engineering and technical assistance contracts used to support the program office.

Finding A. Reimbursable Orders for Intra-Agency Contracting

Transfer of Reimbursable Funds to Keyport. Various funding documents allow the transfer of funds within the Navy from one activity to another. The program office used NAVCOMPT Form 2276A, "Order for Work and Services/Direct Citation," a multipurpose Navy Comptroller form that may be issued on a reimbursable basis, direct-cite basis, or both. The form allows requiring activities (customers) the flexibility to allocate funds provided on the order between direct cite and reimbursable. However, the program office issued and Keyport accepted all of the orders from the program office on a 100-percent-reimbursable basis even though the majority of the work was placed on contract and should have been direct cited. No recommendation is being made regarding this issue because compliance with existing regulations will eliminate the problem.

Keyport Control of Reimbursable Funds. When Keyport accepts funds on a reimbursable basis versus direct cite, Keyport has ultimate control of the funds and can charge various inappropriate taxes and convert excess program office funds for use by Keyport. Keyport does not have access to direct cite funds and could not charge taxes or any other Keyport charges to direct cited funds. Details of the inappropriate Keyport taxes charged to the program office reimbursable orders are discussed in Finding B.

In one instance, Keyport was able to convert excess program office funds for use by Keyport and not return excess funds to the sponsor by converting a cost-reimbursable order to a fixed-price order. When Keyport converted the order to fixed-price, the excess funds belonged to Keyport. For example, Keyport accepted reimbursable order N0001995WXC3AFL (Appendix C, review item number 22) for \$230,000 on January 6, 1995. A delivery order was issued to OCI on January 20, 1995 for \$207,093. The delivery order was later modified and the scope of work reduced by \$84,874, reducing the delivery order amount to \$122,219. Keyport costs on the reimbursable order were \$15,000 for a total cost of \$137,219. At some unknown time after the reimbursable order was accepted by Keyport, the Keyport comptroller converted the order to a fixed-price order. As a result, \$92,781 of excess program office funds were not returned to the sponsor but were converted for use by Keyport. The Keyport comptroller could provide no cases where excess program office funds were returned to the sponsor. No recommendation is being made regarding this issue because had the funds been correctly direct cited, Keyport would never have had access to the funds. However, we do recommend that the performance of key financial managers at Keyport be thoroughly reviewed.

Management Comments on the Finding and Audit Response

Management Comments. The Navy disagreed with the facts in the finding. The Navy fact-finding team determined that most of the work provided by OCI should be counted as in-house work or services for the purposes of determining compliance with the 51-percent in-house rule. Therefore, the Navy contended that the findings of improperly accepting reimbursable orders, contract off-loading, and banking of funds were baseless. The Navy stated that in accordance with the memorandum of agreement between Keyport and the program office, Keyport was the technical manager for the orders. Therefore, Keyport provided detailed guidance and technical input to the contractor, and the contractor costs should be considered in-house.

Audit Response. We disagree with the Navy fact-finding team that the work provided by OCI should be counted as in-house work for the purpose of determining compliance with the Navy 51-percent in-house rule. Table 4 shows that 92 percent of the funds spent on reimbursable orders were for contractor services and materials. Of the remaining 8 percent of the funds, only 5 percent actually represented labor and travel costs associated with Keyport employees. The other 3 percent represented costs associated with technical and purchasing support offices, strategic initiatives, and Vitro support. Further, although we did not calculate exactly how much of the Keyport labor and travel costs (5 percent) actually represented Keyport "value-added technical and engineering support," the 5 percent also included a significant amount of Keyport labor costs associated with contract execution and management services. Consequently, any value-added technical and engineering support from Keyport had to be minimal. In addition, we reviewed the OCI delivery orders for each reimbursable order and found that the contractor was clearly required to prepare the specific deliverables for the program office. Keyport employees may have reviewed the deliverable and provided some technical support, but the actual contract deliverables were prepared by the contractor. In short, Keyport could not demonstrate that it produced the product or deliverable required by the program office.

Management Comments. The Navy commented that the term "uncommitted funds" in Tables 3 and 4 was confusing and that these funds represent "unexpended balances."

Audit Response. To clarify our term "uncommitted funds," these were funds that were reported as uncommitted on Keyport's own accounting records. The majority of these funds will eventually be obligated and then expended on the OCI contract once exact requirements are determined and the delivery orders are issued.

Recommendations, Management Comments, and Audit Response

A.1. We recommend that the Aviation Training Systems Program Manager, Naval Air Systems Command, require that acquisition managers:

a. Direct cite funds for intra-agency contracting when the performing activity will not perform at least 51 percent of the work or services with in-house resources.

Management Comments. The Navy concurred, stating that funds are issued on a direct cite basis when program managers determine that supplies or services will be contracted out. Initial training was provided to program managers on November 15, 1996.

Audit Response. The Navy comments are partially responsive. Although the Navy concurred, it is clear that the Navy does not believe a problem exists based on its comments to the finding. The Navy comments to the finding concluded that the contractor services were considered in-house services and therefore the supplies or services were not considered contracted out. Therefore, the program office is not required to direct cite the funds and can continue to issue orders on a reimbursable basis to Keyport, get the funds obligated, and eventually have the funds put on contract. As stated above we do not agree. We request that the Navy reconsider its position and provide comments on the recommendation as part of its comments on the final report.

b. Discontinue issuing orders for work and services to other Navy organizations without an adequate description of the work or services required.

Management Comments. The Navy concurred, stating that a policy statement defining minimum description requirements would be released by January 15, 1997.

c. Determine whether a valid requirement exists for the uncommitted Keyport reimbursable order funds or whether the funds can be put to a better use.

Management Comments. The Navy concurred and has determined that a valid requirement existed for all of the uncommitted funds. As of November 15, 1996, funds held at Keyport without commitment had been reduced from \$7.9 million to \$153,400.

Audit Response. The Navy comments are responsive. We commend the Navy for getting the uncommitted funds obligated for valid requirements so quickly after receiving the draft report.

Finding A. Reimbursable Orders for Intra-Agency Contracting

A.2. We recommend that the Commander, Naval Undersea Warfare Center, Division, Keyport:

a. Require that the Keyport comptroller, deputy comptroller, and other fund managers not accept orders on a reimbursable basis unless at least 51 percent of the work or services will be performed with in-house resources.

Management Comments. The Navy concurred, stating that Keyport issued guidance on April 9, 1996, to all responsible individuals outlining the financial responsibilities on acceptance and management of customer funds. Included in the guidance was specific direction concerning the 51-percent in-house rule.

Audit Response. The Navy comments are partially responsive. As previously discussed in the response to the finding and Recommendation A.1.a., we request that the Navy reevaluate its position concerning the 51-percent in-house rule and provide comments on the recommendation as part of its comments on the final report.

b. Direct the Keyport comptroller to return the uncommitted Keyport funds to the program office on reimbursable orders that were improperly accepted.

Management Comments. The Navy nonconcurred, stating that the Keyport comptroller, deputy comptroller, and other fund managers had complied with the Navy 51-percent in-house rule for reimbursable orders.

Audit Response. The Navy comments are not responsive. We disagree that the Keyport comptroller, deputy comptroller, and other fund managers complied with the Navy 51-percent in-house rule for NAVAIR reimbursable orders. Although the Keyport fund managers for NAVSEA programs clearly understood the guidance and were in compliance, the fund manager for NAVAIR programs was less clear on the guidance and indicated that the Keyport comptroller office had a ruling from the Navy Comptroller that the contractor support should be considered in-house work. However, when we questioned the Keyport comptroller about the Navy Comptroller ruling that the contractor services should be considered in-house work, we were informed that no such guidance existed. Again, see the audit response to the finding and Recommendation A.1.a. for an explanation of why the contractor services should not be considered in-house Keyport work.

A.3. We recommend that the Commander, Naval Undersea Warfare Center, Newport, Rhode Island, review the performance of the Keyport comptroller, deputy comptroller, and other fund managers who disregarded Navy Comptroller guidance on the 51-percent in-house rule for reimbursable orders and take appropriate action.

Management Comments. The Navy nonconcurred, stating that the Keyport comptroller, deputy comptroller, and fund managers had complied with the Navy 51-percent in-house rule.

Finding A. Reimbursable Orders for Intra-Agency Contracting

Audit Response. The Navy comments are not responsive. We disagree that Keyport had complied with the Navy 51-percent in-house rule for the reasons discussed in the audit response to the finding and Recommendations A.1.a. and A.2.b. We request that the Navy reevaluate its position concerning the 51-percent in-house rule and provide comments on the recommendation as part of its comments on the final report.

A.4. We recommend that the Comptroller, Naval Air Systems Command:

a. Deobligate program office reimbursable funds that are returned by Keyport and review program office requirements for funds.

Management Comments. The Navy concurred with the recommendation, stating that valid requirements at Keyport existed for most of the uncommitted funds and that the funds had been obligated. The remaining uncommitted funds were deobligated and applied to other valid NAVAIR Aviation Training Systems unfunded requirements.

b. Make accounting adjustments to fund labor and travel costs for contract execution and management services at Keyport and Keyport taxes totaling \$1,132,168 with operation and maintenance funds versus procurement funds or provide justification for the use of procurement funds.

Management Comments. The Navy concurred, stating that funding documents were being reviewed to determine the appropriate funding; however, the Navy also noted that procurement funds may be used to fund field support services integral to the execution of procurement programs. The estimated completion date for funds determination is February 15, 1997.

Finding B. Keyport Taxes and Stabilized Rate

Keyport has improperly charged taxes to its Defense Business Operations Fund (DBOF) customers in addition to its approved stabilized rate (cost per direct labor hour). The costs associated with these taxes were excluded from the approved Keyport stabilized rate and reflected a lower than actual stabilized rate. In addition, these taxes were not visible on the primary Keyport accounting records because the costs were accumulated in an account used to document contractor services costs. As a result, the Keyport stabilized rate charged to DBOF customers was understated. Consequently, DBOF customers were not protected from these unforeseen cost increases and were charged additional taxes of about \$26 million in FYs 1995 and 1996, so that Keyport could recover its actual costs.

DoD DBOF Guidance

DBOF Budget Formulation. DoD 7000.14-R, "DoD Financial Management Regulation," Volume 2B, "Budget Presentation and Formulation," Chapter 9, May 1994, provides guidance on the policies and justification procedures for DBOF budget formulation. Section 090103, "Policy," part H., "Full Recovery of Costs and the Setting of Prices," states:

1. Managers of business areas within the Fund are required to set their prices based upon full cost recovery, including all general and administrative support provided by others. Prices are established through the budget process and remain fixed during the year of execution. This stabilized rate policy serves to protect customers from unforeseen inflationary increases and other cost uncertainties and better assures customers that they will not have to reduce programs to pay for potentially higher-than-anticipated prices. In turn, this policy allows activities to execute the budgeted program level and permits a more effective use of Fund resources.

3. The prices set for all business area processes will match the rate changes approved during the budget review.

Section 090203, "Supply Management Business Area," identifies "surcharge" and provides the following definition.

Surcharge. Factors added to the latest acquisition cost or repair cost price of an item to arrive at the customer's standard or exchange price. Surcharges will include: (1) transportation, for such costs as deliveries from production site to points of use or storage; (2) inventory obsolescence and loss, for the costs of pilferage, damage, deterioration, physical inventory shortages and excess; (3) inventory

Finding B. Keyport Taxes and Stabilized Rate

maintenance; (4) supply operations support costs; (5) inventory augmentation; (6) depreciation; and (7) carcass attrition costs, if applicable.

DBOF Policy and Procedures. DoD 7000.14-R, Volume 11B, "Reimbursable Operations, Policy and Procedures--Defense Business Operations Fund," December 1994, provides DoD policy for DBOF operations.

A.1.h. Stabilized Rates and Prices. Defense Business Operations Fund activities operate on a break-even basis over the long term. Customer rates shall be established on an end product basis whenever feasible. The term "end product" means the item or service requested by the customer (output) rather than processes or other inputs in the achievement of the requested output (for example, the product requested rather than the direct labor hours expended in the achievement of that product). Rates are required to be established at levels estimated to recover the cost of products or services to be provided, as well as approved surcharges. The budget process is the mechanism used to ensure that adequate resources are budgeted in the customer's appropriated fund accounts to pay the established rates. Once established, rates are stabilized (held constant) for the applicable fiscal year. This "stabilized rate" policy serves to protect appropriated fund customers from unforeseen cost changes and thereby enables customers to more accurately plan and budget for DBOF support requirements.

Direct and Indirect Costs. The Federal Acquisition Regulation (FAR) provides guidance on direct and indirect costs.

FAR 31.202 Direct costs. (a) A direct cost is any cost that can be identified specifically with a particular final cost objective.

FAR 31.203 Indirect costs. (a) An indirect cost is any cost not directly identified with a single, final cost objective, but identified with two or more final cost objectives or an intermediate cost objective.

Keyport Taxes and Stabilized Rate

Keyport Taxes. Keyport has improperly charged various taxes to its DBOF customers in addition to the stabilized rate approved in the budget. In addition to the Keyport stabilized rate, Keyport charged reimbursable customers taxes of 3.1 percent for technical support office costs, 1.3 percent for purchasing support office costs, and 2 percent for contract administration costs. The technical and purchasing support office taxes were applied to all costs charged to the reimbursable orders. The contract administration office taxes were applied to all contract delivery orders issued. Reimbursable customers were also charged a "futures tax" for strategic initiatives (costs to develop new business for Keyport) that totaled \$2.8 million in FYs 1995 and 1996. The costs associated with these futures taxes were selectively charged to reimbursable orders.

Finding B. Keyport Taxes and Stabilized Rate

Keyport Stabilized Rate. DoD policy provides that DBOF activities operate on a "break even" basis through the establishment of stabilized rates. Stabilized rates are established at an amount estimated to recover DBOF operating expenses. Stabilized rates recover the cost of products as well as approved surcharges. Rates are established in the budget process and held constant to protect customers from unforeseen cost changes. The approved Keyport stabilized rates for FYs 1995 and 1996 were \$66.48 and \$69.09 per labor hour, respectively.

Keyport Effective Stabilized Rate Charged to the Program Office

Keyport billed reimbursable customers an effective stabilized rate that was significantly higher than the budgeted Keyport stabilized rate. The effective stabilized rate includes taxed costs associated with the technical and purchasing support offices and strategic initiatives. Keyport also did not properly allocate costs for its support services contractor (Vitro) to program office reimbursable orders.

Table 6 shows that the average labor rate charged to reimbursable orders from the program office was about \$69 per hour, which was consistent with the approved budgeted Keyport stabilized rate. However, when the total taxes were added to the labor costs, the effective labor rate charged by Keyport increased to \$117 per hour.

Finding B. Keyport Taxes and Stabilized Rate

Table 6. Keyport Labor Costs, Technical and Purchasing Office Taxes, and Futures Taxes Charged to the Program Office

Item Number	Reimbursable Amount	Labor Hours	Labor Costs	Technical and Purchasing Office Taxes	Futures Taxes	Total Labor and Taxes	Labor Hourly Rate	Effective Hourly Rate
1	\$ 185,000	547.5	\$ 33,896	\$ 14,614	\$ 0	\$ 48,510	\$61.91	\$ 88.60
2	458,000	294.5	22,774	0	17,882	40,656	77.33	138.05
3	441,000	759.0	47,026	33,035	0	80,061	65.67	105.48
4	527,000	463.0	30,334	2,867	0	33,201	65.52	71.71
5	362,000	566.0	35,664	0	0	35,664	63.01	63.01
6	210,000	0.0	0	25,688 ¹	0	25,688		
7	200,000	31.5	2,094	4,684	13,625	20,303	66.48	647.71
8	250,000	0.0	0	95	0	95		
9	150,000	211.0	14,028	6,550	0	20,578	66.48	97.53
10	250,000	1318.0	96,859	3,597		100,456	73.48	76.22
11	450,000	150.0	10,040	18,624	0	28,664	66.93	191.09
12	7,580,000	1,271.5	85,469	140,838 ²	68,572	294,879	67.22	231.91
13	950,000	1,846.0	114,627	11,121	0	125,748	62.09	68.12
14	157,500	1,768.0	106,905	1,299	49,259	157,463	60.47	89.06
15	586,993	654.0	43,447	33,677	0	77,124	66.43	117.93
16	900,000	49.0	3,362	484	43,892	47,738	68.61	974.24
17	10,000,000	2,659.0	182,746	21,629	124,842	329,217	68.73	123.81
18	423,356	0.0	0	127	0	127		
19	789,995	36.0	2,419	70,950 ³	0	73,369	67.19	2,038.03
20	340,586	732.0	50,367	5,705	0	56,072	68.81	76.60
21	350,000	2,123.0	169,180	19,298	0	188,748	79.69	88.78
22	230,000	116.0	7,712	1,352	5,828	14,892	66.48	128.38
23	300,000	249.0	16,554	5,040	0	21,594	66.48	86.72
24	900,000	40.0	2,764	35,935	0	38,699	69.10	967.48
Total	\$26,991,430	15,884.0	\$1,078,267	\$457,209	\$323,900	\$1,859,546	\$67.88	\$ 117.07 ⁴

¹Includes \$8,000 of Vitro Support.

²Includes \$95,325 of Vitro NAVAIR Program Management Support.

³Includes \$41,168 of Vitro Support.

⁴Excluding Vitro costs results in an effective hourly rate at Keyport of \$108.

Keyport Business Costs Charged to DBOF Customers

Service Cost Centers. Keyport established two service cost centers (technical and purchasing support offices) and removed the costs for these centers from the indirect overhead costs, which were used to calculate the stabilized rate. The technical support office maintains an "information system network" of computers at Keyport, and the purchasing support office provides purchasing support for Keyport. Both cost centers were needed for base operations. However, the operations of both cost centers could neither be readily identifiable to a specific unit of measure, nor could a direct cost be identified specifically with a particular final cost objective (DBOF customer). Because Keyport could not bill its DBOF customers for these costs as direct costs, Keyport taxed its reimbursable customers for these costs as a percentage of all

Finding B. Keyport Taxes and Stabilized Rate

costs charged to the orders. However, these taxes had no direct relationship to the customer reimbursable orders, making them an additional indirect overhead cost, which should have been included in the stabilized rate.

Contract Administration. Keyport also charged its DBOF customers a technical surcharge of 2 percent on the value of each contract or delivery order issued on behalf of the DBOF customer. The 2 percent was an amount established by the Keyport comptroller to recover costs associated with the Keyport contract administration office. No direct relationship existed between these costs and customer reimbursable orders; therefore, these costs should have been considered indirect overhead costs and included in the Keyport stabilized rate.

Strategic Initiatives. The Weapons Systems Development Center at Keyport supports the program office and manages the reimbursable orders. The Weapons Systems Development Center had allocated \$1.4 million per year to be assessed against reimbursable orders for strategic initiatives or costs to develop new business for Keyport. These strategic initiative costs were selectively charged to program office reimbursable orders even though they had no direct relationship to the work funded by the order. Again, these costs were indirect overhead costs and should have been included in the Keyport stabilized rate.

Taxes Accumulated in Contractor Services Account. These taxes charged to reimbursable customers were not visible on the primary Keyport accounting records. Instead, the costs associated with the taxes were accumulated in the account used to document contractor services costs. Initially, the comptroller stated that only the stabilized rate was being charged to reimbursable customers. However, a detailed review of all costs charged to program office reimbursable orders determined that Keyport also charged various taxes that were not readily apparent on the Keyport accounting records.

Total Costs Taxed to DBOF Customers. Keyport excluded costs for its technical and purchasing support offices and strategic initiatives from overhead and the stabilized rate and charged these costs as additional taxes to reimbursable customers.

By charging costs for the service cost centers and strategic initiatives as taxes, Keyport was able to understate its stabilized rate in the budget but still recover its actual costs. However, DBOF customers were not protected from unforeseen cost increases and were charged higher than anticipated costs of about \$26 million in FYs 1995 and 1996. Keyport should discontinue taxing reimbursable customers for technical and support office costs and strategic initiative costs. Keyport should include technical and purchasing support office costs and strategic initiative costs in its stabilized rate for FY 1997 and, if necessary, request a waiver through the appropriate channels to bill reimbursable customers the correct stabilized rate. Keyport also needs to include technical and purchasing support office costs and strategic initiative costs in the development of stabilized rates for the FY 1998 budget. NAVSEA needs to review billing practices of other DBOF activities and reemphasize DoD policy relating to stabilized rates and improper taxes.

Finding B. Keyport Taxes and Stabilized Rate

Table 7 shows costs that Keyport excluded from overhead and the Keyport stabilized rate and charged to DBOF customers as additional taxes.

Table 7. FYs 1995 and 1996 Keyport Costs That Were Taxed to DBOF Customers

	<u>1995</u>	<u>1996</u>	<u>Total</u>
Technical Support Office	\$11,785,171	\$10,108,369	\$21,893,540
Purchasing Support Office	843,850	761,620	1,605,470
Strategic Initiatives	<u>1,400,000</u>	<u>1,400,000</u>	<u>2,800,000</u>
Total	\$14,029,021	\$12,269,989	\$26,299,010

Management Comments on the Finding and Audit Response

Management Comments. The Navy stated that Keyport did not charge taxes to its DBOF customers but did misapply some service cost center charges. Service cost center charges are an accepted business practice for DBOF activities reflected in annual budgets. Therefore, any corrections for service cost center charges will not affect stabilized rates.

Audit Response. We classified the Keyport Service Cost Center charges as taxes because the charges were applied to all work charged as an additional percentage of the cost of the work performed with no direct relationship to the work, similar to a tax, and because the charges were called taxes on Keyport financial records. Keyport still needs to charge these costs in a way that directly relates to the work being performed; otherwise, the costs associated with the service cost centers would have to be included in overhead, which would affect the stabilized rate. As shown in Table 6, when the Keyport service cost center charges were added to the Keyport stabilized rate, the effective hourly rate for work performed at Keyport was significantly higher than the stabilized rate.

We also question the Navy's use of service cost centers, which are not addressed in the DoD DBOF guidance. DoD 7000.14-R, Volume 2B, Chapter 9, explains how to calculate direct labor hour rates for establishing stabilized rates. The guidance states:

The direct labor hour rate is computed by dividing the sum of all labor, nonlabor, and material direct, indirect, general and administrative expenses projected to be incurred by the depot (or other business area) during the fiscal year, by the total number of direct labor hours (or other outputs) anticipated to be accomplished during the fiscal year.

Finding B. Keyport Taxes and Stabilized Rate

The guidance does not address removing indirect expenses from the stabilized rate and charging the costs as service cost center charges.

Recommendations, Management Comments, and Audit Response

B.1. We recommend that the Commander, Naval Undersea Warfare Center, Division, Keyport:

a. Discontinue taxing reimbursable customers for technical and support office costs and strategic initiative costs.

Management Comments. The Navy concurred, stating that although some service cost center charges were misapplied, the charges were not taxes but appropriate charges to recoup the costs of "specialized operations." The Navy stated that all Keyport service cost center charges will fully comply with this recommendation beginning in FY 1997 and that procedures and processes will be documented in Keyport Command directives by January 31, 1997.

Audit Response. The Navy comments are partially responsive. Whether the service cost center charges for the purchasing support office (acquisition services) and the technical support office (information technology services) represent specialized operations that require service cost centers is questionable. Establishing service cost centers to charge these costs effectively lowers the Keyport stabilized rate. In addition, these service cost center charges appear to be contrary to the stabilized rate concept. We request that the Navy provide additional information on why the Keyport purchasing support office and technical support office represent "specialized operations" that require service cost centers and provide additional comments on the recommendation as part of its comments on the final report.

b. Include technical and purchasing support office costs and strategic initiative costs in its stabilized rate for FY 1997 and, if necessary, request a waiver through the appropriate channels to bill reimbursable customers the correct stabilized rate.

Management Comments. The Navy nonconcurred, stating that service cost centers are an approved and budgeted DBOF business practice according to NAVCOMPT Manual 052400. The Navy stated that the strategic initiatives process was canceled in FY 1996 and therefore not part of the FY 1997 budget. The divestment of the technical support office and the structural changes to the purchasing support office retain the service cost centers, which are revenue neutral. Therefore, a waiver request to change the Keyport stabilized billing rate is not required.

Audit Response. The Navy comments are partially responsive. The costs for strategic initiatives have been canceled. The issue of whether to charge costs associated with the technical support office and the purchasing support office as

Finding B. Keyport Taxes and Stabilized Rate

service cost center or include them in the stabilized rate should be resolved in the Navy comments to Recommendation B.1.a. We request that the Navy reconsider its position and provide comments on the recommendation as part of its comments on the final report.

c. Include technical and purchasing support office costs and strategic initiative costs in the development of stabilized rates for the FY 1998 budget.

Management Comments. The Navy nonconcurred for the reasons discussed in the management comments to Recommendation B.1.b.

Audit Response. The Navy comments are partially responsive. The issue of whether to charge costs associated with the technical support office and the purchasing support office as service cost center or include them in the stabilized rate should be resolved in the Navy comments to Recommendation B.1.a. We request that the Navy reconsider its position and provide comments on the recommendation as part of its comments on the final report.

B.2. We recommend that the Commander, Naval Sea Systems Command, instruct the Director, Defense Business Operation Fund, to review the formulation of the stabilized rate and the appropriateness of billing practices for service cost centers for other Defense Business Operation Fund activities and reemphasize DoD policy relating to stabilized rates and improper taxes.

Management Comments. The Navy nonconcurred, stating that additional guidance to NAVSEA field activities was unnecessary because there was no indication of a systemic problem within NAVSEA. However, lessons learned from the audit will be compiled and passed on to appropriate field activities.

Audit Response. The Navy comments are partially responsive. Again, the issue of whether to charge costs associated with the technical support office and the purchasing support office as service cost center or include them in the stabilized rate should be resolved in the Navy comments to Recommendation B.1.a. We request that the Navy reconsider its position and provide comments on the recommendation as part of its comments on the final report.

Finding C. Government Property

Keyport improperly provided office furnishings and data processing equipment as Government property to the Keyport support services contractor supporting the program office. Keyport also purchased Government property with investment funds (APN) when expense funds (O&M,N) were more appropriate. This condition occurred because Keyport had not designated a Government property administrator for its support services contracts and because Keyport assigned property administration responsibilities to technical assistants who were unfamiliar with Government property regulations. Also, Government property was not adequately controlled and managed by Keyport or the contractor. As a result, Keyport provided office furnishings and data processing equipment totaling \$195,913 to its support services contractor as Government property that should have been financed by the contractor. Keyport also used investment funds totaling \$219,444 to purchase data processing equipment for Government use that should have been financed with expense funds.

Guidance on Providing Government Property to Contractors

DoD Policy. On November 25, 1986, the Under Secretary of Defense for Acquisition issued a memorandum on Government-owned property in the possession of Defense contractors that states:

The new procurement of industrial facilities with defense funds for use by contractors must be drastically limited if we are to reduce government-ownership. Providing existing government property to contractors must also be limited. This property shall be financed by the private sector except under highly unusual circumstances. Part 45.302 of the Federal Acquisition Regulation (FAR) sets forth exception when facilities may be provided.

The contracting activities' implementation of FAR exceptions have become too loose and are permitting the furnishing of large amounts of general purpose equipment that should be privately financed.

All DoD components must exercise more discipline in carrying out the existing policies not to provide government-owned facilities to defense contractors.

DoD 4161.2-M, "DoD Manual for the Performance of Contract Property Administration," December 1991, provides instructions to ensure uniformity and consistency in the administration of contract provisions relating to Government property in the possession of contractors and provides directions for Government Property Administrators.

Finding C. Government Property

It is the Government's policy to rely upon Government contractors to be accountable for and maintain official records of Government property in their possession. The role of the Property Administrator is to support the contract administration function. The Property Administrator acts on behalf of the contracting office and is appointed in writing by a "Certificate of Appointment." The primary responsibility of the property administrator is to administer the provisions of Government contracts that deal with Government property. The property administrator is also responsible for: reviewing contracts assigned for property administration; to assure that property is identified in the contract; to establish contract property control data files; assess the effectiveness of contractor Government property management systems and provide guidance, counsel and direction to Government and contractor managers and technicians for management of Government property.

Federal Acquisition Regulation. FAR part 45, "Government Property," prescribes policies and procedures for providing Government property to contractors.

FAR subpart 45.302-1, "Policy," states:

(a) Contractors shall furnish all facilities required for performing Government contracts except as provided in this subsection. Government facilities provided to contractors shall be individually identified in the solicitation, if possible, and contract. Agencies shall not furnish facilities to contractors for any purpose, including restoration, replacement, or modernization, except as follows:

(1) For use in a Government-owned contractor-operated plant operated on a cost-plus-fee basis.

(2) For support of industrial preparedness programs.

(3) As components of special tooling or special test equipment acquired or fabricated at Government expense.

(4) When, as a result of the prospective contractor's written statement asserting inability to obtain facilities, the agency head or designee issues a Determination and Finding (see Subpart 1.7) that the contract cannot be fulfilled by any other practical means or that it is in the public interest to provide the facilities. . . .

(5) As otherwise authorized by law or regulation.

(d) Government facilities with a unit cost of less than \$10,000 shall not be provided to contractors unless--

(1) The contractor is a nonprofit institution of higher education or other nonprofit organization whose primary purpose is the conduct of scientific research;

(2) A contractor is operating a Government-owned plant on a cost-plus-fee basis;

(3) A contractor is performing on a Government established installation;

(4) A contractor is performing under a contract specifying that it may acquire or fabricate special tooling, special test equipment, and components thereof subsequent to obtaining the approval of the contracting officer; or

(5) The facilities are unavailable from other than Government sources.

Finding C. Government Property

FAR subpart 45.502, "Contractor Responsibility," states:

(a) The contractor is directly responsible and accountable of all Government property in accordance with the requirements of the contract. This includes Government property in the possession or control of a subcontractor. The contractor shall establish and maintain a system in accordance with this subpart to control, protect, preserve, and maintain all Government property. This property control system shall be in writing unless the property administrator determines that maintaining a written system is unnecessary. The system shall be reviewed and, if satisfactory, approved in writing by the property administrator.

(f) When Government property (excluding misdirected shipments, see 45.505.12) is disclosed to be in the possession or control of the contractor but not provided under any contract, the contractor shall promptly (1) record such property according to the established property control procedure and (2) furnish to the property administrator all known circumstances and data pertaining to its receipt and a statement whether there is a need for its retention.

(h) When unrecorded Government property is found, both the cause of the discrepancy and actions taken or needed to prevent recurrence shall be determined and reported to the property administrator".

Supplemental Navy Guidance. On August 4, 1993, and August 29, 1994, the Office of the Assistant Secretary (Research, Development and Acquisition) issued memorandums throughout the Navy reiterating the DoD policy for providing Government property to contractors. The memo states it is DoD policy to require contractors to furnish all equipment and facilities necessary to perform Government contracts. This policy is intended over time to reduce the amount of equipment in the contractor's possession as old contracts are closed and excess facilities are disposed of. Preferably, contractors should furnish their facilities and capitalize the costs.

Guidance on Use of Appropriations

Expense Versus Investment Criteria. NAVCOMPT Manual series Volume 7, "Financial Management Policy," August 15, 1995, Chapter 5, "Financial Responsibility," provides guidance on general funding policy and expense and investment criteria. Costs budgeted in and financed by the O&M,N appropriation are considered expenses. Expenses are costs of resources consumed in operating and maintaining DoD. Costs budgeted in and financed by the APN appropriation are considered investments. Investments are costs of capital assets such as real property and equipment. According to NAVCOMPT guidance, equipment items having a unit value of \$50,000 or less are generally considered expenses and equipment items having a unit cost of more than \$50,000 are generally considered investments. (The expense and investment thresholds have been increased to \$100,000 since the last revision of NAVCOMPT Manual, Volume 7.)

Use of Customer Appropriations. DoD 7000.14-R, Volume 11B, section A.1.i., "Restrictions on Use of Customer Appropriations," provides guidance on the limitations and restrictions imposed on appropriated funds for DBOF activities.

Statutory limitations and restrictions imposed on the appropriated funds of a Defense Business Operations Fund customer are not changed when the customer places an order with the Fund. A Defense Business Operations Fund customer cannot use its appropriated funds to do indirectly, i.e., through placement of an order with a Defense Business Operations Fund activity, what it is not permitted to do directly. Thus, the availability of an appropriation cannot be expanded or otherwise changed by transfer to the Defense Business Operations Fund. Appropriated funds cited on reimbursable orders are available only for the purposes permissible under the source appropriation and remain subject to the same restrictions. The ordering activity is primarily responsible for the determination of the applicability of the ordering appropriation. However, if instances arise when it is apparent that the ordering appropriation is not appropriate for the purpose provided, then the order should be returned with a request for an applicable appropriation cite.

Government Property

Government Property Provided to Support Services Contractor. Keyport improperly provided office furnishings and data processing equipment as Government property to OCI, a Keyport support services contractor supporting the program office. Office furnishings and data processing equipment are usually plant equipment and therefore subject to the requirements for facilities in the FAR. Contractor representatives would request the facility items through Keyport technical assistants who in turn would have the items procured through the Keyport purchasing office. We visited an OCI facility in Oklahoma City, Oklahoma, and found that the entire contractor facility was furnished with Government property supplied by Keyport. Included in the items provided as Government property were 5 executive desks with unit prices of \$1,055, 3 chairs with unit prices of \$550, a 3-seat sofa for \$819, a secretarial desk for \$888, and 10 bookcases with a unit price of \$401.

Property for Government Use. Keyport also improperly purchased facilities with investment funds for use by the program office, program office sponsors, and Keyport that met expense funding criteria. Program office representatives would request facility items such as laptop computers through the Keyport technical assistants, who would have the Keyport purchasing office procure the items. Keyport also used investment funds to procure facilities for a computer-based training center located at Keyport.

Administration of Government Property

Designation of Property Administrator. Although Keyport had a Government property administrator, the property administrator had not been assigned responsibility for the OCI contracts. Also, the contracting officer located at the Fleet Industrial Supply Center, Bremerton, was unaware Keyport was providing facilities to OCI as Government property. The Commander, Keyport, should assign a property administrator to the OCI contracts to ensure compliance with regulations on providing facilities to contractors as Government property.

Role of Technical Assistants. Keyport technical assistants (logistics personnel) were responsible for the procurement of facilities provided to OCI as Government property and also for the procurement of other facilities for Government use. However, these Keyport technical assistants were unfamiliar with regulations relating to Government property and expense and investment criteria for procuring facilities. The technical assistants lacked training in property administration and did not have property administration responsibilities in their performance standards.

During negotiations of delivery orders between Keyport and OCI, the technical assistants provided contract negotiators with a property list of items to be provided as Government property. The property list was developed based on contacts between the technical assistants and OCI. OCI and the program office regularly called the Keyport technical assistants and requested facilities as Government property. The technical assistant then contacted vendors for the facilities to obtain price quotes and referred the best price to the Keyport purchasing office. The purchasing office subsequently purchased the property based on the technical assistant recommendation. The Government property was then either shipped directly to OCI or through Keyport. The Commander, Keyport, should require that Keyport technical assistants not provide facilities to contractors as Government property unless approved by the Keyport Government property administrator.

Controlling and Managing Government Property. Keyport also did not have an effective system to control and manage contractor-acquired Government property. For example, delivery order 18, dated April 10, 1996, on OCI contract N00406-95-D-5062, identified contractor-acquired Government property of about \$2 million. This delivery order was funded by reimbursable order N0001995WXBSDEA (review item number 17 of Appendix C). The purpose of the delivery order was to convert existing training systems for F/18 maintenance technicians into electronic classrooms and learning resource centers. The Government property for the OCI, Jacksonville, Florida, office included computer hardware and software and would be returned to the Government in 7 months for eventual use at a Government facility. However, again Keyport had not assigned responsibility for this Government property to a Keyport property administrator and adequate procedures had not been established to properly control and manage the Government property.

Government Property for Contractor Use

Keyport provided office furnishings and data processing equipment totaling \$195,913, to OCI as Government property that should have been financed by OCI (see Table 8). Providing these items to OCI increased the investment in Government property by DoD and also increased the associated administrative burden. OCI should have furnished the items and capitalized the cost.

Table 8. Office Furnishings and Data Processing Equipment Provided to OCI as Government Property

<u>Item Number</u>	<u>Description</u>	<u>Appropriations</u>	<u>Cost</u>
3	Desktop Computers, Software, Furniture	O&M, N	\$129,977
6	Desktop Computers, Software, Furniture	APN	59,460
23	Computer Software	APN	990
24	Desktop Pentium Computers	APN	5,486
Total			\$195,913

In addition, neither Keyport nor OCI had adequate records of the Government property provided to OCI. OCI did not provide Keyport an annual report of all Government-furnished property on hand as required (DD Form 1662). Further, the Government property on hand at OCI offices was not properly identified with Government property records and lacked proper accounting such as national stock numbers, quantities on hand, and accurate unit prices. We also were unable to locate and identify all property items such as chairs and tables issued to OCI. While Keyport property records identified \$195,913 of Government property at OCI, OCI property records showed Government property valued at \$226,565 as of April 1, 1996. The Keyport Government property administrator and OCI need to reconcile Government property records.

Expense Versus Investment Items

Keyport used \$219,444 of investment funds to procure data processing equipment and other items for use by the program office, program office sponsors, and Keyport that should have been financed with expense funds (see Table 9). Keyport used investment funds to procure data processing equipment, books, signs, and memberships without determining whether the items should have been properly financed with expense funds. Also, Keyport used program office investment funds to acquire computer hardware and software for a Keyport computer-based training center.

Finding C. Government Property

Table 9. Data Processing Equipment and Other Items Purchased for Government Use With Investment Funds

<u>Item Number</u>	<u>Description</u>	<u>Appropriation</u>	<u>Cost</u>
<u>Located at Program Office</u>			
20	Laptop Computer	APN	\$ 4,769
21	Laptop Computer	APN	3,876
24	Desktop Pentium Computer	APN	<u>5,486</u>
Subtotal Program Office			\$ 14,131
<u>Located at Training Activities</u>			
17	Supplies, Software	APN	\$ 28,885
21	Computer Workstations	APN	122,359
24	Desktop Pentium Computers	APN	<u>10,972</u>
Subtotal Training Activities			\$162,216
<u>Located at NUWC Keyport</u>			
10	Books, Signs	APN	\$ 507
12	Computer Hardware and Software	APN	1,954
13	Computer Hardware and Software	APN	7,418
17	Desktop Pentium Computers, Memberships*	APN	18,371
19	Computer Hardware	APN	139
20	Laptop Computer, Software	APN	8,261
24	Desktop Pentium Computer	APN	<u>6,447</u>
Subtotal Keyport			\$ 43,097
Total			\$219,444
*1-year membership (\$5,000) to Software Productivity Consortium, Inc., Herndon, VA.			

The Commander, Keyport, should require the Keyport comptroller to review the data processing equipment and other items procured for Government use with investment funds, determine whether expense funds should have financed the facilities, and take appropriate action. The Commander, Naval Air Systems Command, should reemphasize to all program offices that reimbursable orders and intra-agency contracting will not be used to circumvent established procedures for procuring Government property.

Management Comments on the Finding and Audit Response

Management Comments. The Navy stated that all Government property records and reports were being reviewed and reconciled. Keyport provided Government-furnished property for a Government-owned, contractor-operated training facility with all property titled to the Government. This determination was made by the contracting officer under FAR 45.3. Funding documents will also be reviewed to determine whether general purpose equipment was purchased in accordance with expense and investment criteria.

Audit Response. The Government property identified in Table 8 was not located at a Government-owned, contractor-operated training facility. The audit team physically inspected the Government property at an OCI facility in Oklahoma City, Oklahoma. Further, the Government property was not provided to OCI under a DoD contract or approved by the contracting officer but was purchased by the Keyport purchasing support office and shipped directly to the contractor facility.

Recommendations, Management Comments, and Audit Response

C.1. We recommend that the Commander, Naval Undersea Warfare Center, Division, Keyport:

a. Assign a property administrator to the OCI contracts to ensure compliance with regulations on providing office furnishings and data processing equipment to contractors as Government property.

Management Comments. The Navy concurred, stating that a Government property administrator has been assigned to the OCI contracts to ensure compliance with Government property regulations.

b. Require that Keyport technical assistants not provide office furnishings and data processing equipment to contractors as Government property unless approved by the Keyport Government property administrator.

Management Comments. The Navy concurred, stating that technical assistants have received training in property administration procedures. Keyport Supply Department Instruction 4341.1, dated August 29, 1996, defines the roles and responsibilities for all officials responsible for Government property.

Finding C. Government Property

c. Require that the Keyport Government property administrator assigned responsibility for the OCI contracts determine whether the \$2 million of contractor-acquired Government property on OCI delivery order 18, contract N00406-95-D-5062, is appropriate and whether adequate procedures have been established to control and manage the Government property.

Management Comments. The Navy concurred, stating that the contracting officer and the Government property administrator are reviewing all property purchased under the OCI delivery order. The review will be completed by March 1, 1997.

d. Require that the Keyport Government property administrator reconcile Government property records with OCI.

Management Comments. The Navy concurred, stating that a reconciliation is underway and will be completed by March 1, 1997.

e. Require that the Keyport comptroller review data processing equipment and other items procured for Government use with investment funds, determine whether expense funds should have financed the property, and take appropriate action.

Management Comments. The Navy concurred, stating that Keyport used procurement funds to procure equipment and material for Government use instead of financing the purchases with expense funds in accordance with investment and expense criteria. Corrective action by the Keyport comptroller and the program office should be completed by March 1, 1997.

C.2. We recommend that the Commander, Naval Air Systems Command, reemphasize to all program offices that reimbursable orders should not be used to circumvent established procedures for procuring Government property.

Management Comments. The Navy concurred, stating that NAVAIR will ensure emphasis on compliance with existing guidance and regulations. The program office received initial training on the use of program dollars to procure Government property for contractors on November 15, 1996. Additional training will be provided as required.

Part II - Additional Information

Appendix A. Scope and Methodology

Scope

Audit Scope. We reviewed reimbursable orders issued to Keyport from the program office and other Navy organizations for FYs 1992 through 1995. We judgmentally selected 19 NAVAIR FY 1995 reimbursable orders for review totaling \$25.3 million or 99 percent of the NAVAIR funds sent to Keyport. We judgmentally selected 5 additional NAVAIR reimbursable orders from previous years valued at \$1.7 million. Of the 24 NAVAIR reimbursable orders reviewed, 19 were issued by the program office and 5 were issued by NAVAIR organizations and related to training areas under the overall cognizance of the program office. We also judgmentally selected for review 17 reimbursable orders issued by Naval Sea Systems Command Sponsors valued at \$96.6 million. In total, we reviewed 41 reimbursable orders issued to Keyport totaling \$123.6 from FYs 1992 through 1996. In FY 1995, Keyport received reimbursable orders from 17 major sponsors totaling \$258 million.

Audit Period and Standards. We performed this economy and efficiency audit from January through August 1996 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. We included tests of management controls considered necessary. No statistical sampling procedures were used during the audit.

Methodology

Review of Reimbursable Orders. We reviewed reimbursable orders and determined the amount of work or services contracted out on each order. We compared the description of work or services on reimbursable orders and air tasks with contract delivery orders. We reviewed Keyport supplemental accounting records, official accounting records, and contracts and delivery orders to identify Keyport taxes and other charges. Also, we interviewed Keyport officials, program office officials, DoD and Navy DBOF officials, and Naval Air System Command budget policy and comptroller officials.

Use of Computer-Processed Data. We relied on computer-processed data generated by the Navy Operating Management Information System to determine reimbursable order charges. Although we did not perform a formal reliability assessment of the computer-processed data, we determined that the labor and overhead charges were consistent with the stabilized rate and that material and contract costs generally agreed with the information in the computer-processed data. We did not find errors that would preclude use of the computer-processed data to meet the audit objectives of the audit or that would change the conclusions in the report.

Organizations Visited or Contacted

Contacts During the Audit. We visited and contacted individuals within the DoD and the Small Business Administration.

Management Control Program

DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987,* requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of Review of Management Control Program. We reviewed the adequacy of the management control procedures at Keyport. We did not review the adequacy of management control procedures at NAVAIR because the procedures were recently reviewed and commented on in Inspector General, DoD, Report No. 96-059, "Complaint to the Defense Hotline on Sole-Source Section 8(a) Contracts at the Naval Air Systems Command," January 16, 1996. We did not review the adequacy of management control procedures at NAVSEA because the focus of the audit was Keyport and the NAVAIR program office. We also reviewed the adequacy of management controls over the issuance and acceptance of reimbursable orders and providing Government property to contractors. Specifically, we reviewed the Keyport management control program to determine whether management control reviews were scheduled and performed. We also reviewed the Keyport vulnerability assessments that rated each of the program assessable units.

Adequacy of Management Controls. We identified material management control weaknesses at Keyport as defined by DoD Directive 5010.38. The Keyport management controls were not adequate to prevent Keyport from accepting reimbursable orders for intra-agency contracting when 51 percent of the work or services would not be performed with in-house resources. Keyport management controls neither prevented Keyport from charging inappropriate taxes to reimbursable customers nor prevented Keyport from providing general purpose equipment to contractors as Government property. There also were sufficient management control problems with taxes being charged to DBOF customers and the purchase of Government property for NAVAIR and NAVSEA to reemphasize policy. The recommendations in this report, if implemented, will improve the management control program at Keyport and could result in potential monetary benefits of \$7.9 million (Appendix D). A copy of the report will be provided to the senior official responsible for management controls in the Office of the Chief of Naval Operations.

*DoD Directive 5010.38 has been revised to "Management Control Program" as of August 26, 1996. This audit was performed under the 1987 version.

Appendix A. Scope and Methodology

Adequacy of Management's Self-Evaluation. In July 1995, Keyport identified 120 assessable units covering 15 major program areas. Only one assessable unit, the motor pool, was rated high risk. Keyport officials identified acceptance of reimbursable work requests and Government furnished material as assessable units; however, Keyport assigned a low level of risk to both assessable units. Keyport considered the areas to be low priority and did no further testing. We believe that Keyport should have assigned a high level of risk to both areas and conducted evaluations of the applicable management controls. Because Keyport did not conduct the evaluation, Keyport did not identify or report the material management control weaknesses identified by the audit.

Appendix B. Summary of Prior Audits and Other Reviews

There have been numerous audits and reviews addressing inter-agency contracting problems but only a few on intra-agency contracting problems. The problems associated with both inter-agency and intra-agency contracting are similar.

Inspector General, DoD

Report No. 96-203. "Contracted Services For the Medium Altitude Endurance Unmanned Aerial Vehicle Joint Project Office," July 31, 1996. The report states that the Joint Project Office for the Medium Altitude Endurance Unmanned Aerial Vehicle used intra-agency contracting with other Navy organizations to place sole-source orders greater than \$1 million to the same contractor without appropriate reviews by the NAVAIR contracts division. Consequently, the contractor was awarded a high-risk mix of overlapping labor contracts (time-and-materials, firm-fixed-price, and cost-plus-fixed-fee), and the contractor charged DoD contracts questionable labor costs totaling \$379,257 for calendar years 1993 and 1994. The report recommended providing additional guidance and training on intra-agency contracting and renegotiating contract labor hour rates. Management concurred with the recommendations.

Report No. 94-088. "DoD Procurements through the Tennessee Valley Authority Technology Brokering Program," October 20, 1993. The report states that DoD organizations issued Economy Act orders to the Technology Brokering Program, circumventing the Federal procurement process; that DoD organizations did not provide for adequate contract administration and contract audits to verify that work was performed in accordance with the Tennessee Valley Authority cooperative agreements; and that in FY 1992, the Tennessee Valley Authority earned about \$3.5 million in interest by requiring DoD to make payments before receiving goods and services. The report recommends that the Deputy Under Secretary of Defense (Environmental Security) revise DoD Instruction 4000.19, "Interservice, Interdepartmental, and Interagency Support," April 15, 1992, to prevent DoD misuse of Economy Orders, obtain a refund of unliquidated advance payments, and transfer funds based on incurred costs. The Army, Navy, and Air Force generally agreed with the recommendation. The Deputy Under Secretary of Defense (Environmental Security) reissued DoD Instruction 4000.19 in August 1995 with an effective date of October 1, 1995.

Congressional Report

Congressional Report. U.S. Senate, Subcommittee on Oversight of Government Management of the Committee on Governmental Affairs, "Offloading: The Abuse of Inter-Agency Contracting to Avoid Competition and Oversight Requirements," January 27, 1994. This report states that tens of millions of dollars annually have been spent unnecessarily by Federal agencies through the use of "offloads" and that fees as high as 20 percent have been charged to customers wanting to offload contract requirements. The Committee found that offloads are appropriate only in specific, narrowly defined circumstances. The Committee also found that offloads are frequently used to avoid competition and to direct contracts to favored customers, to improperly obligate expiring yearend appropriations before they revert to the Treasury, and to make inappropriate purchases. In addition, the Committee found that offloads have resulted in shoddy contract administration; agencies have paid excessive and unnecessary fees to offload contracts; and agencies have consistently failed to take adequate action against offloading practices. The Committee made the following recommendations:

- o A Government-wide system should be instituted to track offloaded contracts;
- o Offloads should be used only when they are likely to result in increased efficiency and reduced costs because of the contracting agency's unique capabilities or expertise;
- o Offloads are appropriate when the contracting agency has already entered into a contract to purchase the same or similar goods or services for its own use or the purchase is of another type specifically authorized by law or regulation;
- o Offloads should be permitted only with advance approval of a contracting officer or other official specifically designated by the requesting agency to approve such purchases;
- o Federal agencies should be prohibited from charging any fee for an offload that exceeds the actual or estimated cost of entering into and administering the offloaded contract; and
- o Agencies should take appropriate disciplinary action against officials who are found to have engaged in improper or abusive offloads.

Appendix C. Program Office Reimbursable Orders Reviewed

<u>Item Number</u>	<u>Document Number</u>	<u>Appropriation*</u>	<u>Reimbursable Amount</u>	<u>Description of Work or Services</u>
1	R5560293P00001	1731804	\$185,000	E-6A engineering support.
2	N0001994WXBSGUA	1741506	458,000	T-45TS engineering technical Services and support.
3	R5560294WR00203	1741804	441,000	E-6A program training systems analysis and technical services.
4	N0001995WXBSCGA	1751506	527,000	Computer training systems for the aviation multifunction electronic warfare trainer program.
5	N0001993WXBSG8A	1731506	362,000	Curriculum development for aircraft survivability equipment.
6	R5560294WR00210	1741804	210,000	E-6A aircrew coordination training curriculum and technical engineering support services.
7	N0001995WXBS59LA	1751804	200,000	Multifunctional electronic warfare training curriculum update.
8	N0001995WXBSEQA	1751506	250,000	Software technology for adaptable and reliable systems and service life extension program software integration.
9	N0001995WXBS55L	1751804	150,000	Multiplatform Electronic Warfare Navy training plans.
10	N0001995WXBSA8L	1751804	250,000	Engineering and technical training in support of weapons training team.
11	N0001995WXBS4PA	1751506	450,000	Engineering and technical support for E-6A flying qualities improvement.
12	N0001995WXBS4NA	1751506	7,580,000	Engineering and technical support for E-6A mission trainer flight manager computer system trainer.

*Components of designation code for appropriation column: For 1731804, 17 denotes NAVAIR, 3 denotes Fiscal Year, and 1804 denotes O&MN. For 1731506, 1506 denotes APN.

Appendix C. Program Office Reimbursable Orders Reviewed

<u>Item Number</u>	<u>Document Number</u>	<u>Appropriation*</u>	<u>Reimbursable Amount</u>	<u>Description of Work or Services</u>
13	N0001995WXBS3LA	1751506	950,000	Engineering analysis and specification design and modification of 15G series air traffic control trainers.
14	N6133995WR50121	1751804	157,500	Engineering technical services and travel for device 2Hi111 block upgrade.
15	R5560295WR00200	1751804	586,993	E-6A training systems engineering support.
16	N0001995WXBSCMA	1751506	900,000	E-6A spare parts acquisition to support training system.
17	N0001995WXBSEDA	1741506	10,000,000	Engineering and technical support to upgrade F/A-18 training system.
18	N0001995WXBShPA	1751506	423,356	F/A-18 training system upgrade.
19	N0001995WXB55WA	1751506	789,995	Engineering, training, and technical and logistics services for T-45TS devices.
20	N0001995WXB5GKA	1751506	340,586	Spare parts to upgrade cockpit procedures trainer to operational flight trainer.
21	N0001995WXB5DWA	1751506	350,000	Computer based training initiative for the AV-8B Harrier training systems.
22	N0001995WXC3AFL	1751804	230,000	Engineering technical services for the A-8B Harrier training systems.
23	N0001995WXB59CA	1751506	300,000	Curriculum development of interactive software for aircraft and survivability equipment.
24	N0001995WXB5GJA	1751506	900,000	Spare parts to support the E-6A training systems.

*Components of designation code for appropriation column: For 1731804, 17 denotes NAVAIR, 3 denotes Fiscal Year, and 1804 denotes O&MN. For 1731506, 1506 denotes APN.

Appendix D. Summary of Potential Benefits Resulting from Audit

Recommendation Reference	Description of Benefit	Amount and Type of Benefit
A.1.a.	Compliance With Regulations or Laws and Management Controls. Prevents uncommitted funds from being obligated.	Nonmonetary.
A.1.b.	Compliance With Regulations or Laws and Management Controls. Prevents funds from being obligated without a bona fide need.	Nonmonetary.
A.1.c.	Compliance With Regulations or Laws and Economy and Efficiency. Determines whether a valid requirement exists for uncommitted funds.	Nonmonetary.
A.2.a.	Compliance With Regulations or Laws and Management Controls. Prevents the acceptance of reimbursable orders unless 51 percent of the work or services are performed with in-house resources.	Nonmonetary.
A.2.b.	Compliance With Regulations or Laws and Management Controls. Prevents uncommitted funds from being obligated.	Nonmonetary.
A.3.	Compliance With Regulations or Laws and Management Controls. Prevents managers from disregarding Navy Comptroller guidance.	Nonmonetary.
A.4.a.	Compliance With Regulations or Laws and Management Controls. Correctly reflects the status of funds.	Nonmonetary.

Appendix D. Summary of Potential Benefits Resulting From Audit

Recommendation Reference	Description of Benefit	Amount and Type of Benefit
A.4.b.	Compliance With Regulations or Laws and Management Controls. Prevents the improper use of procurement funds.	Nonmonetary.
B.1.a.	Compliance With Regulations or Laws. Protects DBOF customers from unforeseen cost increases.	Nonmonetary.
B.1.b.	Compliance With Regulations or Laws. Charges DBOF the correct stabilized rate.	Nonmonetary.
B.1.c.	Compliance With Regulations or Laws. Reflects the actual Keyport stabilized rate in the FY 1998 budget.	Nonmonetary.
B.2.	Compliance With Regulations or Laws and Management Controls. Improves controls over stabilized rates at DBOF activities.	Nonmonetary.
C.1.a.	Compliance With Regulations or Laws and Management Controls. Prevents facilities from being provided to contractors as Government property.	Nonmonetary.
C.1.b.	Compliance With Regulations or Laws and Management Controls. Prevents facilities from being provided to contractors as Government property.	Nonmonetary.
C.1.c.	Compliance With Regulations or Laws and Management Controls. Provides controls over Government property provided to contractors.	Nonmonetary.
C.1.d.	Compliance With Regulations or Laws and Management Controls. Accounts for Government property at contractor offices.	Nonmonetary.

Appendix D. Summary of Potential Benefits Resulting From Audit

Recommendation Reference	Description of Benefit	Amount and Type of Benefit
C.1.e.	Compliance With Regulations or Laws and Management Controls. Prevents the improper use of investment versus expense funds.	Nonmonetary.
C.2.	Compliance With Regulations or Laws and Management Controls. Improves controls over Government property.	Nonmonetary.

Appendix E. Report Distribution

Office of the Secretary of Defense

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Naval Air Systems Command, Aviation Training Program Office
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Naval Undersea Warfare Center, Division, Keyport, Washington

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Justice, Committee on Government Reform and Oversight
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Part III - Management Comments

Department of the Navy Comments



THE ASSISTANT SECRETARY OF THE NAVY
(FINANCIAL MANAGEMENT AND COMPTROLLER)
1000 NAVY PENTAGON
WASHINGTON, D.C. 20350-1000

07 JAN 1997

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING,
DEPARTMENT OF DEFENSE

Subj: DRAFT REPORT ON THE AUDIT OF REIMBURSABLE ORDERS ISSUED TO
THE NAVAL UNDERSEA WARFARE CENTER, KEYPORT, WASHINGTON,
PROJECT NO. 6CF-8009.01

Ref: (a) DODIG memo of 24 Oct 96

Encl: (1) DON Response to DODIG Draft Audit Report, Project
No. 6CF-8009.01

I am responding to the draft audit report forwarded by
reference (a) concerning Reimbursable Orders Issued to the Naval
Undersea Warfare Center, Keyport, Washington.

The Department of the Navy (DON) response is provided at
enclosure (1). Although I concur with many of the report
findings and recommendations, I object to the broad sweeping
conclusions based on an erroneous analysis of a small sampling of
the work conducted at Keyport. Tables and calculations in the
draft report excluded the value of in-house contracts from the 51
percent in-house calculations and show unexpended funds as
"uncommitted." Finally, the draft report recommendations do not
support the accusations regarding "contract off-loading and
"banking of funds". As outlined in the enclosed comments, the
DON has taken and will continue to take appropriate action to
ensure that all applicable recommendations are implemented.

Deborah P. Christie

DEBORAH P. CHRISTIE
Assistant Secretary of the Navy
(Financial Management and Comptroller)

Copy to:
NAVINGEN (2)

Department of the Navy Response
to
DODIG Draft Report of 24 October 1996
on
Reimbursable Orders Issued to the
Naval Undersea Warfare Center Keyport, Washington
Project No. 6CF-8009.01

In response to the DODIG Draft Report, the Commander, Naval Undersea Warfare Center (COMNUWC) established a fact finding team comprised of financial, contracting, legal, technical and auditing professionals to review the findings and recommend corrective actions. Based upon that team's review, the Department of the Navy (DON) agrees, in part, with the findings and recommendations detailed in the DODIG draft report. The team validated shortcomings regarding controls over the purchase and control of government property; the use of sponsor funds to pay for productivity initiatives that do not directly benefit programs; and, the incorrect use of APN funds to purchase equipment. Corrective actions, as outlined in the response, have either been taken or are planned to strengthen management controls in these areas.

However, the Navy does not concur with the characterization of the relationship between the Naval Undersea Warfare Center, Division Keyport (Keyport) and the Naval Aviation Training System Program Office (PMA-205). PMA-205 developed a long standing partnership with Keyport, codified by a Memorandum of Agreement (MOA) which provides detailed mutual responsibilities in support of Naval Air Systems Command (NAVAIRSYSCOM) training requirements. PMA-205 sought the services of Keyport because of its expertise in computer-based training. As such, Keyport provides substantial, value-added, technical and engineering support for NAVAIRSYSCOM training requirements.

Finding A: Reimbursable Orders for Intra-Agency Contracting

The Naval Aviation Training Systems program office (the program office) improperly issued reimbursable orders to the Naval Undersea Warfare Center, Keyport (Keyport) without an adequate description of the work or services required. This was done in order to get the funds obligated. Keyport improperly accepted, on a reimbursable basis, orders from the program office for intra-agency contracting and disregarded Navy comptroller

Enclosure (1)

guidance that requires at least 51 percent of the work or services be performed with in-house resources before a reimbursable order can be accepted. This was done to obtain additional business and to obtain control over the funds. As a result, the program office was able to "off-load" contracts to obtain services from a desired contractor and avoid contracting oversight. The program office also banked (obligated without a bona fide need) appropriated funds to reduce oversight of uncommitted funds. The program office used procurement funds to obtain contract execution and management services from Keyport. Keyport obtained additional reimbursable business, charged the program office improper taxes, and converted excess program office funds for its own use. As of 1 April 1996, Keyport accounting records show 9 reimbursable orders from the program office with about \$7.9 million of uncommitted FYs 1994 and 1995 APN funds that have been uncommitted for an extended period of time and with questionable requirements.

DON Position: Non-concur. The COMNUWC Team found that only 5 of the 24 reimbursable orders cited by the DODIG had inadequate descriptions of work. The COMNUWC Team also determined that most of the work provided by OCI should be counted as in-house work or services and that PMA-205 had valid requirements for all of the work. Therefore, the allegations of "improperly accepted reimbursable orders", "contract off-loading", and "banking of funds" are baseless. Although some funds may have been obligated prematurely, funds were obligated within the definition of bona fide need. Additionally, contractual functions provided by Keyport were integral to the execution of assigned tasks under the MOA between Keyport and PMA-205. Further, there is no evidence that Keyport converted excess funds accepted on a reimbursable basis for its own use.

Specifically, the DON 51 percent rule defines "in-house" as including the costs of all direct labor, material and supplies, travel and minor equipment, authorized overhead costs for activities authorized to distribute overhead, and, contracts for technical support usable only to the performing activity in accomplishing its overall work for the user. In accordance with the MOA between Keyport and PMA-205, Keyport was the technical manager for these tasks. As such, Keyport provided detailed guidance and technical input to the contractor. References to the NAVAIRSYSCOM 80 percent guidance is not relevant to this draft report since this guidance was issued in February 1996 and only applies to work performed at NAVAIRSYSCOM Defense Business Operations Fund (DBOF) activities.

Finally, references to "uncommitted funds" in Tables 3 and 4 and other parts of the draft report are confusing. These funds represent "unexpended balances" which are spent over the life of the order for work or services. A summary of data on Keyport financial records, as of 30 September 1996, is shown below for 9 documents cited by the DODIG in Table 3 of the draft report. Eight of the 9 documents show expenditures within 90 days of acceptance.

Item Number	Days to First Expenditure (Contract Liability)	Funded Amount (\$K)	Reasonable Description of Intended Work	Unexpended Funds (\$K) 9/30/96
4	53	527	Yes	21
8	71	250	Yes	0
12	37	7,580	Yes	537
17	8	10,000	Yes	81
18	Returned after 1 year	423	Yes	0
19	79	790	Yes	0
20	14	341	Yes	1
23	33	300	Yes	0
24	45	900	Yes	30

Recommendation A.1.a.: We recommend that the Aviation Training Systems Program Manager, Naval Air Systems Command require that acquisition managers direct cite funds for intra-agency contracting when the performing activity will not perform at least 51 percent of the work or services with in-house resources.

DON Position: Concur. Funds are issued on a direct cite basis when program managers have determined that supplies or services will be contracted out. However, when using the NAVCOMPT Form 2276A the requesting and performing activities will make a reasonable assumption as to how much of the order will be accepted on a reimbursable and/or direct cite basis. Initial training was provided on 15 November 1996 to program managers specific to the use and preparation of the appropriate funding documents. Additional training will be provided as required.

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Recommendation A.1.b.: We recommend that the Aviation Training Systems Program Manager, Naval Air Systems Command require that acquisition managers discontinue issuing orders for work and services to other Navy activities without an adequate description of the work or services required.

DON Position: Concur. The COMNUWC Team determined that the NAVAIR Aviation Training Systems Program Office provided sufficient descriptions of work in 19 of the 24 funding documents referenced in the draft report--only 5 were deficient. However, a policy statement which defines minimum description requirements, including financial reporting, for inclusion in AIRTASKs, Statements of Work and/or funding documents will be released by 15 January 1997. Program Office Budget Financial Managers will review funding documents to ensure compliance with policy.

Recommendation A.1.c.: We recommend that the Aviation Training Systems Program Manager, Naval Air Systems Command require that acquisition managers determine whether a valid requirement exists for the uncommitted reimbursable order funds or whether the funds can be put to a better use.

DON Position: Concur. The Aviation Training System Program Office has determined that a valid requirement exists for the uncommitted reimbursable funds and will ensure that all uncommitted funds are applied to OPNAV approved naval aviation training program requirements. Additionally, a review of outstanding APN documents in Table 3 of the draft report confirms that additional commitments were made, or funds withdrawn reducing the amount held at Keyport, without commitments from \$7,900,000 to \$153,400 as of 15 November 1996. The applicable program managers either have additional tasks supporting work completion dates still in the future, or documents in process to withdraw funds not required by Keyport. No savings will accrue or be available for use by other programs or for other purposes.

Recommendation A.2.a.: We recommend that the Commander, Naval Undersea Warfare Center, Division, Keyport require that the Keyport comptroller, deputy comptroller, and other funds managers not accept orders on a reimbursable basis unless at least 51 percent of the work or services will be performed with in-house resources.

DON Position: Concur. Keyport issued guidance on 9 April 1996 to all responsible individuals outlining the financial responsibilities on acceptance and management of customer funds. Included in this guidance were specific direction concerning 51 percent of the work requested utilizing in-house resources.

Recommendation A.2.b.: We recommend that the Commander, Naval Undersea Warfare Center, Division, Keyport direct the Keyport comptroller to return the uncommitted funds to the program office on reimbursable orders that were improperly accepted.

DON Position: Non-concur. Each of the nine items referred to in Table 3 of the draft report included an adequately detailed description of work. In each instance Keyport began work well within 90 days except for the one order Keyport returned without doing any work. Thus, Keyport accepted these reimbursable orders properly. As of 15 November 1996, of the \$7.9 million identified as uncommitted in Table 3 of the draft report, only \$153,400 remained uncommitted. The remaining funds are expected to be fully committed by 31 January 1996.

Recommendation A.3.: We recommend that the Commander, Naval Undersea Warfare Center, Newport, Rhode Island review the performance of the Keyport comptroller, deputy comptroller, and other fund managers that disregarded Navy Comptroller guidance on the 51 percent in-house rule for reimbursable orders and take appropriate action.

DON Position: Non-concur. Based on the COMNUWC Team review, there is no substantiation of the finding that the Keyport comptroller, deputy comptroller, and other fund managers "disregarded" the 51 percent rule. Adherence to the DON 51 percent rule was documented through procedures and check lists going back to 1986. No additional action is required.

Recommendation A.4.a.: We recommend that the Comptroller, Naval Air Systems Command deobligate uncommitted program office reimbursable funds that are returned by Keyport and review program office requirements for funds.

DON Position: Concur. As stated in recommendation A.1.c. valid requirements existed for most of the uncommitted program dollars. The remaining uncommitted funds held by Keyport have been deobligated and applied by the NAVAIR Aviation Training Systems to work in progress, or against other valid unfunded requirements approved by OPNAV.

Recommendation A.4.b.: We recommend that the Comptroller, Naval Air Systems Command make accounting adjustments to fund labor and travel costs for contract execution and management services at Keyport and Keyport taxes totaling \$1,132,168 with operation and maintenance funds versus procurement funds or provide justification for the use of procurement funds.

DON Position: Concur. Funding documents are being reviewed to determine appropriate funding, however, procurement funds may be used to fund field support services integral to the execution of procurement programs. Estimated completion date is 15 February 1997. Additionally, Keyport business initiatives will be examined by PMA-205 and appropriate action taken to recoup funds via the NAVAIRSYSCOM Comptroller (Table 6 of draft report, less Item Numbers 14 and 22). Estimated completion is 15 February 1997.

Finding B: Keyport Taxes and Stabilized Rate

Keyport has improperly charged taxes to its Defense Business Operations Fund (DBOF) customers in addition to its approved stabilized rate (cost per direct labor hour). The costs associated with these taxes were excluded from the approved Keyport stabilized rate to reflect a lower than actual stabilized rate. In addition, these taxes were not visible on the primary Keyport accounting records because the costs were accumulated in an account used to document contractor service costs. As a result, the Keyport stabilized rate which was charged to DBOF customers was understated. Consequently, DBOF customers were not protected from these unforeseen cost increases, and were charged additional taxes of about \$26 million in FYs 1995 and 1996, so that Keyport could recover its actual costs.

DON Position: Non-concur. Keyport did not charge taxes to its DBOF customers, but it did misapply some Service Cost Center (SCC) charges. SCCs are an accepted business practice for DBOF activities reflected in annual budgets. Therefore, any corrections for SCC charges will not affect stabilized rates. Keyport's FY 1995 and FY 1996 stabilized rates were calculated using DOD budget guidance and approved in the respective budgets.

Recommendation B.1.a.: We recommend that the Commander, Naval Undersea Warfare Center Division Keyport discontinue taxing reimbursable customers for technical and support office costs and strategic initiative costs.

DON Position: Concur. Although Keyport misapplied some SCC charges, SCCs are not taxes but are appropriate charges to recoup the costs of specialized operations. By NAVCOMPT Manual 052400, "a SCC is neutral or nonparticipative in the overhead structure of an activity. It is neither a Productive nor a General and Administrative Cost Center, but is a category by itself." Hence, these charges are appropriately excluded from the stabilized billing rates.

The SCC charges for the Purchasing Support Office (PSO) and Technical Support Office (TSO) were for acquisition and information technology services. The intent of SCCs is to ensure benefitting customers fund the services received. SCC costs were included in the Keyport approved budget and in cost quotations to the customer. However, Keyport's initial implementation of some SCC charging procedures did not demonstrate benefits to its customers. In the case of the PSO/TSO, Keyport incorrectly charged a flat rate based on dollar value and strategic initiative charges did not demonstrate a direct benefit. This practice was discontinued.

Beginning with FY 1997, all Keyport SCCs are in full compliance. The TSO was divested and its functions distributed. Information Technology (IT) functions driven strictly by DBOF customer workload were moved to production departments. The remaining portions were placed in Keyport overhead (G&A). The PSO no longer charges a flat rate for its services, but recovers costs from its customers based on actual use. To provide a more meaningful breakout of costs, PSO services are categorized into seven individual types of procurement services: MILSTRIP, bankcard, delivery orders, purchase orders, contracts, requests for contractual procurement sent to other agencies, and contract administration. Procedures and processes will be documented in Keyport Command directives to be completed by 31 January 1997.

Recommendation B.1.b.: We recommend that the Commander, Naval Undersea Warfare Center Division Keyport include technical and purchasing support office costs and strategic initiative costs in its stabilized rate for FY 1997 and if necessary, request a waiver through the appropriate channels to bill reimbursable customers the correct stabilized rate.

DON Position: Non-concur. By NAVCOMPT Manual 052400, SCCs are an approved and budgeted DBOF business practice. The PSO and TSO SCCs were included in Keyport's FY 1997 A-11 Budget submissions as revenue neutral entities, were accounted for in the POM

Department of the Navy Comments

process and, therefore, were correctly excluded in the calculation of Keyport's stabilized rates. The Strategic Initiatives process was canceled in FY 1996 and was not a part of the FY 1997 budget. The divestment of TSO and the structural changes to PSO noted in the response above retain SCCs which are revenue neutral. Therefore, a waiver request to change the Keyport stabilized billing rate is not required.

Recommendation B.1.c.: We recommend that the Commander, Naval Undersea Warfare Center Division Keyport include technical and purchasing support office costs and strategic initiative costs in the development of stabilized rates for the FY 1998 budget.

DON Position: Non-concur. See above.

Recommendation B.2.: We recommend that the Commander, Naval Sea Systems Command instruct the Director, Defense Business Operation Fund to review billing practices of the other Defense Business Operations Fund activities and reemphasize DOD policy relating to stabilized rates and improper taxes.

DON Position: Non-concur. Additional guidance to NAVSEASYS COM field activities is unnecessary. There is no indication of a systemic problem within the NAVSEASYS COM claimancy with regard to DBOF billing practices, stabilized rates, or the charging of SCC costs to customers. However, lessons learned from this audit and the findings of the COMNUWC Team will be compiled and promulgated to appropriate field activities.

Finding C.: Government Property

Keyport improperly provided office furnishing and data processing equipment as Government property to the Keyport support services contractor supporting the program office. Keyport also purchased Government property with investment funds (APN) when expense funds (O&M,N) funds were more appropriate. This condition occurred because Keyport had not designated a Government property administrator for its support services contracts and because Keyport assigned property administration responsibilities to technical assistants who were unfamiliar with Government property regulations. Also, Government property was not adequately controlled and managed by Keyport or the contractor. As a result, Keyport provided office furnishings and data processing equipment totaling \$195,913 to its support services contractor as Government property that should have been financed by the contractor. Keyport also used investment funds totaling \$219,444

to purchase data processing equipment for Government use that should have been financed with expense funds.

DON Position: Partially Concur. All Government property records and reports are being reviewed and reconciled. Keyport provided a Government furnished property (GFP) for a government-owned contractor-operated training facility with all property titled to the Government. This determination was made by the Contracting Officer under FAR 45.3. Funding documents are also being reviewed to determine if general purpose equipment was purchased in accordance with the expense-investment criteria.

Recommendation C.1.a.: We recommend that the Commander, Naval Undersea Warfare Center, Division, Keyport, assign a property administrator to the OCI contracts to ensure compliance with regulations on providing office furnishing and data processing equipment to contractors as Government property.

DON Position: Concur. A Government property administrator has been assigned to the OCI contract. By FAR 45.3, compliance with regulations for providing office furnishings and data processing equipment to contractors as GFP is a Contracting Officer's responsibility instead of a property administrator's responsibility.

Recommendation C.1.b.: We recommend that the Commander, Naval Undersea Warfare Center, Division, Keyport, require that Keyport technical assistants not provide office furnishing and data processing equipment to contractors as Government property unless approved by the Keyport Government property administrator.

DON Position: Concur. By FAR 45.3, a Contracting Officer's determination is required before GFP can be provided to a contractor. Property administrators are responsible for the accounting and administration of property after it has been delivered. Technical Assistants have received training in the proper procedures for property administration. Newly issued NUWC DIVKPT Supply Department Instruction 4341.1 of 29 August 1996, defines the roles and responsibilities of the Contracting Officer, the Technical Assistant, the Program Manager, the Contracting Officer's Representative, and the Property Administrator.

Recommendation C.1.c.: We recommend that the Commander, Naval Undersea Warfare Center, Division, Keyport, require that the Keyport Government property administrator assigned responsibility

Department of the Navy Comments

for the OCI contracts determine whether the \$2 million of contractor-acquired Government property on OCI delivery order 18, contract N000406-95-D-5062 is appropriate and whether adequate procedures have been established to control and manage the Government property.

DON Position: Concur. By FAR 45.3, the Contracting Officer, assisted by the Government property administrator, is in the process of reviewing all property purchased under delivery order 18, contract N00406-95-D-5062. This review will be completed by 1 March 1997. Additionally, Keyport has issued NUWCDIVKPT Supply Department Instruction 4341.1 of 29 August 1996, to improve management of GFP.

Recommendation C.1.d.: We recommend that the Commander, Naval Undersea Warfare Center, Division, Keyport, require that the Keyport Government property administrator reconcile Government property records with OCI.

DON Position: Concur. A reconciliation is underway and will be completed by 1 March 1997.

Recommendation C.1.e.: We recommend that the Commander, Naval Undersea Warfare Center, Division, Keyport, require that the Keyport comptroller review data processing equipment and other items procured for Government use with investment funds, determine whether expense funds should have financed the property, and take appropriate action.

DON Position: Concur. Keyport used APN funds to procure equipment and material for Government use instead of financing the purchases with O&MN or OPN funds according to the expense-investment criteria. This issue requires corrective action by Keyport comptroller and PMA-205. Action completion date is 1 March 1997. However, Table 9 of the draft report incorrectly lists training equipment totaling \$162,216 as "Located at Program Office Sponsors." This training equipment supports program office tasking and was provided to Government facilities at Naval Air Station (NAS) Lemoore, Florida; NAS Cecil Field, California; and NAMTRAGRU Headquarters, Pensacola, Florida. The remaining equipment locations shown in Table 9 are correct.

Recommendation C.2.: We recommend that the Commander, Naval Air Systems Command reemphasize to all program offices that reimbursable orders should not be used to circumvent established procedures for procuring Government property.

DON Position: Concur. AIR 1.0 will ensure emphasis on compliance with existing guidance and Federal Acquisition Regulations. Initial training was provided on 15 November 1996 to PMA-205 personnel on the use of program dollars to procure Government property for contractors, program sponsors or program offices. Additional training will be provided as required.

Appendix A: Management Control Program

DON Position: Keyport implemented a comprehensive management control program 6 months prior to the subject audit which identified 120 assessable units covering 15 major program areas. As a result of this audit, Keyport was directed to reassess those units responsible for the financial management of reimbursable funds and property management, and to correct any weaknesses not raised in the DODIG audit report. In addition, the new leadership at Keyport will conduct a review of the management control processes to evaluate and improve its overall effectiveness.

Audit Team Members

This report was prepared by the Contract Management Directorate, Office of the Assistant Inspector General for Auditing, DoD.

Paul J. Granetto
Terry L. McKinney
Henry F. Kleinknecht
David P. Cole
Keith A. Yancey
Kimble L. Powell
Ana M. Myrie

INTERNET DOCUMENT INFORMATION FORM

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C. Report's Point of Contact: (Name, Organization, Address, Office Symbol, & Ph #): OAIG-AUD (ATTN: AFTS Audit Suggestions)
Inspector General, Department of Defense
400 Army Navy Drive (Room 801)
Arlington, VA 22202-2884

D. Currently Applicable Classification Level: Unclassified

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